FINANCIAL INSTITUTIONS COMMITTEE

Business Law Section, State Bar of California

Minutes of the Meeting of August 12, 2008

Committee Members Present:

Meg Troughton, Chair

Rosie Oda, Co-Vice Chair

Bruce Belton, Co-Vice Chair

Bob Stumpf, Secretary

Todd Okun

Keith Ungles

Andy Erskine

Mary Price

Will Stern

Shirley Thompson

Mike Zandpour

Susan Allison

Steve Balian

Craig Chiang

Jason Robman

Advisory Members and Others Present:

Clay Coon

Dick Rogan

David Tollen

Neil Rubenstein

David Kincaid

David Nelson

Stan Ragalevsky

Rick Miller

Neil Martin

Sally Brown

Leland Chan

John Hancock

Bob Mulford

Teryl Murabayashi

Jim Rockett

Maureen Young

Dan Marks

Call to Order: Meg Troughton called the meeting to order at 9:38 a.m.

- 1. Roll Call, Introductions, and Administrative Matters. Meg welcomed Committee Members, Advisory Members, and Guests.
- **2. Approval of July Minutes.** The minutes of the meeting on July 8, 2008, were approved with two minor corrections.
- 3. UDAP Proposal Re Overdraft Services in Reg AA and Reg DD. Shirley Thompson presented a thoughtful and comprehensive report on the proposed rule regarding the Unfair or Deceptive Acts or Practices Act in connection with overdraft services. See Attachment A.

Shirley also presented highlights from Wells Fargo's comments letter, including the recommendation to limit the new rule to balance protection programs (using Reg E for other purposes), focusing on point-of-sale authorizations, and several practical examples of where regulation may be premature.

The comments period is now closed, and is not clear when the new rules will become effective. Shirley kindly offered to report on related developments regarding Reg Z at our next meeting.

- 4. Powers of the FDIC in Receivership. Stan Ragalevsky presented a very thorough summary of the FDIC's receivership powers. Although the bankruptcy code does not apply to banks as such, bank holding companies can file bankruptcy petitions. Stan also provided a very detailed written summary of his comments which he authored with his partner Rick Miller. See Attachment B.
- 5. Fair Value Rule—California Code of Civil Procedure § 580(a). Craig Chiang reported on the opinion from the 4th Appellate District, Division 3, in *Cynthia D. Talbott v. William Hustwit* (no. G037424), filed June 20, 2008. In broad outline, that opinion held that § 580(a) of the Code of Civil Procedure, which requires an appraisal of real property security before the court may issue a deficiency judgment, does not apply for the benefit of guarantors. See Attachment C.
- 6. Mortgage Foreclosures—SB 1137. Neil Rubenstein presented a very helpful report on the enactment of California SB 1137 which added new procedural steps that a lender must follow in California before conducting a non-judicial foreclosure sale under a deed of trust covering the principle residence of any person, when the deed of trust secures a loan made between January 1, 2003, and December 31, 2007.

Among other things, Neil noted that although the intent of this new legislation was to apply to consumer-oriented transactions, it also applies to some commercial transactions. According to Neil, "Section 4 of the new law adds Section 2924.8 to the Civil Code to require a trustee or authorized agent, at the time it posts a notice of sale, to

also post on the property and to mail to the resident of the property, a notice in English with translations in five additional languages, stating that the property may soon be sold at foreclosure." See Attachment D.

Neil also reported that some parts of the act are effective immediately, and others will become effective on September 6, 2008.

- 7. 2008 State Bar Annual Meeting—Joint Program with Consumer Financial Services Committee on Subprime Mortgages. Bruce Belton updated the Committee on the proposed presentation on subprime mortgages that our Committee will present jointly with the Consumer Financial Services Committee on Subprime Mortgages at the State Bar meeting in September.
- **8. Upcoming Section Education Institute on July 16-18, 2009.** Meg Troughton reported briefly on this upcoming meeting.
- 9. Announce 2008-2011 Members and 2008-2009 Officers. Meg Troughton reported that members of the Class of 2011 will include Clay Coon, Leo Graham, Lawrence Hutt, Daniel Loritz, Dick Rogan, and David Tollen.

The officers for 2008-2009 will be Bruce Belton (Chair), Bob Stumpf (Co-Chair), and Joe Sanchez (Secretary).

- 10. Open Meeting and Other Business. Neil Martin reported on the article entitled, "Lawyers Falling Victim," which was posted on the State Bar website in July. It chronicles the unfortunate tale of lawyers who fell victim of an email scheme purporting to seek legal assistance in collecting a debt in the amount of \$193,000, including the issuance of cashier's checks. Note, in particular, that "available" funds are not the same as "collected" funds.
- **11. Adjournment.** Meg Troughton adjourned the meeting at 11:40 a.m.

Respectfully submitted,

Bob Stumpf, Secretary

Attachment A



Overdraft Proposal (UDAP & Regulation DD)

Shirley Ng Thompson, Managing Counsel August 12, 2008



Provisions Relating to Overdraft Services - Talking Points Unfair or Deceptive Acts or Practices Proposed Rule

UDAP Authority

- Substantial consumer injury
- Reasonable ability to avoid the injury
- Countervailing benefits

Partial Opt-out for ATM and POS debit card transactions present significant operational challenges

between authorization and settlement (e.g., holds dropped after 3 days and Fee exceptions do not recognize time gap in merchant payment systems current inability to accurately track a unique transaction's authorization amount compared to settlement amount).



Provisions Relating to Overdraft Services - Talking Points Unfair or Deceptive Acts or Practices Proposed Rule

"POS Transaction" Not Clearly Defined

- Difficult to distinguish between "POS" and "card-not-present" debit card transactions (e.g. for bill payments, utilities and mortgage).
- Confusing to consumers

Debit Holds

 Significant complexity to determine an "excess hold" amount and retroactively determine if fees were assessed in error.



Provisions Relating to Overdraft Services - Talking Points (Cont.) Unfair or Deceptive Acts or Practices Proposed Rule

Unintended consequences

- Low-income "high risk" customers may be adversely affected
- Shift from overdrafts to more returned checks
- Increase in returned item fees for the consumer
- Higher return rate increases merchant's risk
- Merchants may be less willing to accept checks
- May accelerate migration to electronic payments
- Decline rates for debit card transactions may increase
- Uncertainty regarding the effect of pending POS transactions may require a more conservative approach on funds availability. I



Provisions Relating to Overdraft Services - Talking Points (Cont.) Unfair or Deceptive Acts or Practices Proposed Rule

Other Considerations

- The issue to solve for is POS debit card authorization and consumer's ability to make an informed OD decision at time of purchase. ١
- address some of the problems (e.g. automated fuel dispensers: replace \$1 The regulation is premature as the industry is already taking steps to authorization amount intra-day with actual transaction amount). I

Wells Fargo Internal Use Only



Summary: Unfair or Deceptive Acts or Practices Proposed Rule Provisions Relating to Overdraft Services

Scope

- "Accounts" Regulation DD/TISA definition
- Deposit account at a depository institution that is held by or offered to a consumer.
- Excludes prepaid cards.
- "Consumer"
- Person who holds an account primarily for personal, family or household purposes.
- Excludes business accounts, including sole proprietorships.
- "Overdraft Services"
- Service under which an institution charges a fee for paying a transaction that overdraws an account.
- Includes undisclosed as well as promoted programs.
- Excludes lines of credit subject to Regulation Z (transfers from a credit card account, home equity line of credit, overdraft line of credit).
- Excludes transfers from another account of the consumer.



Summary: Unfair or Deceptive Acts or Practices Proposed Rule Provisions Relating to Overdraft Services (Cont.)

Consumer Opt-out Right

- May not assess a fee for an overdraft service unless:
- Bank provides consumer with notice of right to opt out
- Consumer has a reasonable opportunity to opt out, and
- Consumer does not opt out.
- Partial Opt-out Requirement
- Must provide consumer with option to opt out only for payment of overdrafts at ATMs and POS transactions initiated by debit card.
- Notice Requirements
- Notice of opt-out must be given:
- Initially, prior to assessment of overdraft fees
- Subsequently, at least once during any statement period in which the consumer incurs an overdraft fee (unless consumer has opted out)
- Consumer may opt out at any time
- Bank must comply with opt-out request as soon as reasonably practicable



Summary: Unfair or Deceptive Acts or Practices Proposed Rule Provisions Relating to Overdraft Services (Cont.)

Consumer Opt-out Right (Cont.)

- Opt-out continues until revoked by consumer.
- Exceptions to consumer opt-out:
- Notwithstanding consumer opt-out, bank may assess a fee for paying a debit card transaction that overdraws an account if:
- There were sufficient funds in the account at the time the authorization request was received, but the actual transaction amount exceeds the authorized amount.
- The debit card transaction is presented as a paper-based item and the bank had not previously authorized the transaction.



Summary: Unfair or Deceptive Acts or Practices Proposed Rule Provisions Relating to Overdraft Services (Cont.)

Debit Card Holds

Must not charge an overdraft fee if the overdraft would not have occurred but for a hold placed on funds in excess of the actual transaction amount.

Requests for Comment:

- dollar items before larger dollar items for purposes of assessing overdraft Transaction clearing – whether banks should be required to pay smaller
- Partial opt-out whether right to opt out should be extended to only ATM transactions and debit card transactions at the point-of-sale. I
- should be allowed to impose a fee for paying an overdraft even if the consumer Exceptions – whether there are other circumstances in which an institution has opted out of the overdraft service.
- Other areas for comment:
- UDAP Authority
- » Substantial injury
- » Reasonable ability to avoid the injury
- » Countervailing benefits



Summary: Regulation DD Proposal

- format requirements for the substantive out-out requirements described Opt-out Disclosure Requirements – sets out timing, content and in Regulation AA:
- Timing Disclosures will need to be given:
- otherwise in a separate document prior to assessment of overdraft fees provided Initially, either at account opening as part of the account agreement, or the consumer has a reasonable opportunity to opt out.
- Subsequently, at least once during any statement period in which the consumer incurs an overdraft fee, either:
- On a periodic statement containing an overdraft fee, in close proximity to the fees, or
- On an overdraft notice sent to a customer, but only the first one for that statement period.
 - Format and Content
- Must use format substantially similar to new Sample Form B-10 in each instance and include:
- Categories of transactions for which an overdraft fee may be imposed



Summary: Regulation DD Proposal (Cont.)

Opt-out Disclosure Requirements (Cont.)-

- Dollar amount of overdraft fees
- Potential impact of fees (e.g., may be charged for overdrafts as low as \$1)
- Limits on fees or statement that no limits apply
- Disclosure of opt-out right and how consumer may exercise opt-out
- Alternative payment options banks must state whether it offers any alternatives and describe the alternatives (e.g., line of credit).
 - Aggregate Fee Disclosures
- Current requirement will be extended to apply to all banks, not just those that promote overdraft services:
- Total overdraft fees for statement period.
- Total overdraft fees YTD.
- Must conform to specified format (Form B-11).
 Balance Disclosures in Response to Inquiries
- Balance must include only funds available for immediate use or withdrawal.
- A second balance amount may be disclosed that includes other amounts the bank will use to cover overdrafts if the bank prominently indicates that the balance includes these funds.

UDAP Talking Points Regarding Overdraft Services Proposal

- We support the proposal to the extent that it is applied to:
 - Bounce protection programs
 - Potentially misleading promotions to the public
 - Prohibiting the disclosure of "available" balances that include discretionary overdraft lines
- We are concerned about applying the rule to traditional overdraft services
 - Traditional overdraft services benefit consumers
 - The expense to the consumer is almost always higher if a check is returned
 - Paying, rather than returning, checks helps consumers avoid bad credit reports
 - Banks will be forced to cover an overdraft without being compensated for its risk
 - The consumer not the bank is in the best position to know what transactions they have authorized that could affect their account balances
- There may be several unintended consequences
 - Consumers may be confused by the ability to "opt out" of a service that is provided at the bank's discretion
 - Consumers may not understand that they may still incur OD fees even though they opt out
 - Consumers may mistakenly believe that a partial opt out creates a "right" to have checks covered
 - The rule may hurt efforts by institutions to bank the "unbanked"
 - Merchants may become less willing to accept checks
 - The average hold placed on consumer deposits may increase
 - Debit cards may become less available to high-risk consumers
 - Banks may be forced to defend against meritless claims concerning behavior that has never been criticized that took place before the effective date of the rule
- Wells Fargo has a number of practices to help consumers manage their balances:
 - We provide clear disclosures of OD fees when the account is opened
 - We offer a number of ways to avoid ODs (linked accounts, lines of credit, etc.)
 - Consumers have a number of ways to check their balances
 - We offer balance alerts
 - ATM transactions that we know would overdraw an account can be canceled
 - We post deposits before debits
 - We generally provide consumers with next-day availability of their deposits
 - Balance information excludes OD protection and limit amounts)
 - We already take steps to address to problems identified for debit card transactions
- Wells Fargo recommendations include:
 - Limit UDAP rule to "bounce protection" programs
 - The agencies should consider the use of Reg. E and Reg. DD to deal with traditional OD "services"
 - If opt-out is required, avoid any effort to provide a "partial" opt-out solution
 - Change the standard to provide that, if a consumer opts out of overdraft services, the institution is only obliged to make a good faith effort not to authorize a debit or ATM transaction that creates an overdraft
 - Consider whether regulations are premature, in light of industry efforts to improve the customer experience concerning ATM and debit card transactions

Attachment B

Financial Institutions Committee Business Law Section State Bar of California

K&L GATES

An Overview of FDIC Receivership Powers August 12, 2008

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I. Introduction

The failure of IndyMac Bank in July, 2008 has made the legal issues surrounding the insolvency of financial institutions once again a front burner topic for lawyers serving financial institutions and any party having significant contractual or other relationships with banks and thrifts. This is not surprising. The failure of a bank or thrift can have catastrophic consequences for:

- (1) uninsured depositors;
- (2) counterparties to contracts who provided data processing or loan servicing to a failed institution;
- officers of the failed institution with SERPs or other deferred compensation arrangements;
- (4) borrowers having unfunded construction loans or undrawn lines with the failed institution;
- (5) banks having loan participations with the failed institution;
- (6) landlords having leases with the failed institution;
- (7) any counterparty with the benefit of continuing contract representations or warranties under asset sale agreements with a failed institution;
- (8) any counterparty to a contract or with a claim for damages against a failed institution.

II. <u>Insolvency of Financial Institutions is Quite Different from Other Businesses</u>

There are special rules and different processes that come into play when a financial institution fails. While the insolvency of businesses is covered under the provisions of the Federal Bankruptcy Code, the insolvency of banks, thrifts and insurance companies is not. See 11 U.S.C. §109 (b)(2). Financial institutions and insurance companies are specifically exempted from the Bankruptcy Code. The insolvency of a federally insured financial institution (i.e., bank or thrift) is governed by the Federal Deposit Insurance Act ("FDI Act"). 12 U.S.C. §§ 1811-1835. The insolvency of a bank or financial holding company and "non-bank" affiliates, however, is subject to the Bankruptcy Code.

Financial institution insolvencies in the United States have been governed by special statutory provisions since the National Bank Act of 1864. Banks are treated differently than other types of businesses due to their importance in the effective functioning of the economy. Most individuals and businesses maintain some kind of deposit account at a financial institution. Banks are significant providers of credit to consumers and businesses. They are critical to the functioning of the payments system. When a bank fails, it can have a devastating impact not only upon every one of its individual or business customers but also upon the entire area in which it operates. No one wants to deal with -- or risk dealing with -- a bank that cannot meet its

obligations or lacks liquidity. Simply stated, the failure of any bank (but especially a large one) can damage the economy and undermine public confidence more acutely than the failure of almost any other comparably sized private business enterprise. See R. Bliss and G. Kaufman "U.S. Corporate and Bank Insolvency Regimes" 2 <u>Virginia Law & Business Review 143</u> (2007).

Since financial institutions do play such a critical role in our economy, the system for dealing effectively with their insolvency has been structured to expedite the process to maintain public confidence. As the successor in interest to the depositors of a failed bank, FDIC invariably has the largest stake in a bank receivership. The law governing bank receiverships accordingly is designed to promote the prompt resolution of failed banks at the least cost to FDIC.

III. The Bank Resolution or Closing Process

(A) Regulators Determine Insolvency.

The decision to close an insolvent bank is normally made by its primary banking regulator who initiates the closure process by sending a "failing bank letter" about the bank to FDIC. FDIC can also determine on its own to close a bank. The decision is seldom made precipitously. J. Walter "Closing Troubled Banks" 90 Federal Reserve Bank of Richmond Economic Quarterly 51 (2004). It normally comes after a regulatory examination finds the bank to be in a severely weakened condition. The adverse examination findings are usually accompanied by a formal regulatory enforcement action like a cease and desist order designed to force necessary corrective actions. If the bank cannot be returned to a safe and sound condition by its primary regulator and it continues to deteriorate, the bank is declared insolvent by the primary regulator or FDIC. There is no prior judicial involvement or advance opportunity on the part of the failed bank to contest the insolvency and seizure of the bank. See generally OCC, Problem Bank Identification, Rehabilitation and Resolution (January 2001).

(B) Insolvency Defined.

Bank regulators can act quickly to close a troubled bank. They need not wait until a bank is insolvent under a book value (<u>i.e.</u>, the book value of its assets is less than its liabilities) or liquidity (<u>i.e.</u>, unable to pay its liabilities or meet withdrawal demands) definition of insolvency. The FDIC Improvement Act of 1991 ("FDICIA") added a definition of insolvency that gave FDIC the authority to close a bank that was "critically undercapitalized" (<u>i.e.</u>, had less than 2% equity capital to total assets). The FDICIA definition of insolvency allowed FDIC to close a bank that might not have been insolvent under traditional book value or liquidity definitions of insolvency but had no realistic prospect of returning to a safe and sound condition.

(C) Appointment of FDIC.

Once its primary regulator determines a bank to be insolvent, FDIC steps in to "resolve" it by accepting appointment as its conservator or receiver. In some cases, the primary regulator will appoint FDIC as the failed bank's conservator to continue operating the failed bank until it can be rehabilitated or closed. (The OTS did this with IndyMac.) But, in the majority of cases, FDIC is appointed the failed bank's receiver to close it down, wind up its business and manage the orderly liquidation of its assets. 12 U.S.C. §1821(d). Upon being

appointed receiver, FDIC closes the troubled bank, takes control of its assets, records and premises and terminates any involvement of the bank's officers, directors and shareholders in its operation. FDIC succeeds to all rights of the failed bank and has the general authority to operate its business, exercise all the failed bank's corporate powers and even merge it with another bank or transfer its assets to a new "bridge bank" as occurred with IndyMac. 12 U.S.C. 1821(d). FDIC, as receiver or conservator, has authority to determine the validity of creditor's claims of a failed bank. 12 U.S.C. 1821(d)(3). See generally FDIC Resolutions Handbook: Methods for Resolving Troubled Financial Institutions in the United States (1998)

IV. FDIC Receivership Powers

FDIC, as conservator or receiver, steps into the shoes of the failed bank to collect its assets and "resolve" its liabilities. The greatest percentage of claims in amount and kind belong initially to depositors of the failed bank. FDIC, in its "corporate" capacity, succeeds by subrogation to all of the rights of insured depositors in the failed bank by making good on its deposit insurance obligations. 12 U.S.C. §1821(g)(1) and (2). This means FDIC, in its corporate capacity, ends up as the largest creditor of the failed bank's receivership estate. The failed bank's receivership estate is managed by FDIC as receiver. FDIC proceeds to administer the estate in such a way as to maximize recoveries and limit questionable claims. FDIC, as receiver, is not subject to court supervision. Its decisions are, however, subject to limited judicial review. FDIC has a number of important statutory powers available to it when resolving a failed bank in a receivership.

(A) Exclusive Claims Process

12 U.S.C. §1821(d) gives FDIC the power to allow or disallow claims in a bank receivership and sets out the exclusive process by which unsecured claims in receivership can be determined. A proof of claim must ordinarily be submitted by claimants to FDIC within 90 days after FDIC publishes notice of the receivership. This includes parties who may have been suing the failed bank in court at the time of the receivership. FDIC has 180 days to allow or disallow the claim. If the claim is disallowed, the creditor has 60 days to file suit or seek administrative review. If the claim is not acted upon by FDIC as receiver within 180 days of filing, it is automatically disallowed.

Creditors who fail to follow the statutory claim process set forth in 12 U.S.C. §1821(d)(5) will have their claims barred and have no further recourse against FDIC. Creditors with allowed claims are issued receiver certificates for the amount of the claim with dividends paid out as money is available to the class of claim allowed.

(B) Claim Priorities

Since the passage of the National Depositor Preference Amendment in 1993, the priority for paying allowed claims against a failed bank receivership is set forth in 12 U.S.C. 1821(d)(11). This statute establishes the following order of priority, after payment of secured claims, in an FDIC failed bank receivership.

(1) The FDIC's administrative expenses as receiver;

- (2) All deposit liabilities (both insured and uninsured);
- (3) Other general unsecured creditors including contract claims;
- (4) Subordinated obligations; and
- (5) Shareholder claims

The National Depositor Preference Amendment gave a statutory priority to depositors over other unsecured creditors. This means that FDIC, as subrogree of the depositors up to applicable FDIC coverage limits, and uninsured depositors get their claims paid in full before other unsecured creditors get a penny on allowed claims. These include claims from vendors, servicers, suppliers and counterparties to contracts with the failed bank, claims arising from leases, unsatisfied employee claims and claims asserting damages from business decisions of the failed bank or FDIC, as its receiver.

(C) Repudiation of Contracts

Once appointed as receiver or conservator of a failed bank, FDIC has a number of special powers to facilitate its resolution. More extensive than the power accorded to a trustee in a bankruptcy proceeding, these special powers may be exercised by FDIC without prior notice, hearing or judicial approval. Among the most important powers granted to FDIC in a receivership or conservatorship is the ability to repudiate contracts of the failed bank.

(1) Scope of FDIC's Repudiation Rights

FDIC, when acting as conservator or receiver for a troubled bank, may repudiate or disaffirm any contract or lease to which the bank is a party if it: (1) deems performance of the contract or lease to be "burdensome"; and (2) finds that repudiation or disaffirmance of the contract or lease would promote the orderly administration of the receivership estate. 12 U.S.C. 1821(e). The power to repudiate contracts and leases granted to FDIC is similar – but broader – than the power of a debtor-in-possession or trustee appointed by the Bankruptcy Court to reject unwanted executory contracts.

(2) Effects of Repudiation

The repudiation of a contract by FDIC as receiver or conservator terminates any obligation to render future performance required under the contract. The FDIC's power to repudiate a contract in a bank receivership is a particularly potent weapon for a number of reasons:

- a. Unlike a traditional Chapter 11 proceeding, the FDIC can simply repudiate a contract or lease by letter to the affected counterparty without court approval and with no prior notice.
- b. In the traditional bankruptcy proceeding, only "executory" contracts can be avoided by a trustee in bankruptcy. FDIC can, however, repudiate any contract it finds "burdensome." This makes it easier for FDIC to

repudiate revolving lines of credit, partially funded construction loans and letters of credit.

- c. The damages recoverable against FDIC for repudiating a contract in a bank receivership are limited to the counterparty's actual direct, compensatory damages. Consequential damages for lost profits, punitive damages and pain and suffering are barred. Furthermore, damages against FDIC as receiver are generally cut off under the "fixed and certain" rule set forth in 12 U.S.C. 1821(e)(3)(A) as of the date of the receivership. Any damage claim allowed by the FDIC is paid in the form of a "receiver's certificate". Since claims of unsecured creditors are, under the 1993 National Depositor Preference Amendment, subordinate to depositor claims, the likelihood of a dividend being paid out on such a certificate is remote.
- d. There is significant authority under case law interpreting Section 365 of the Bankruptcy Code that a trustee in bankruptcy cannot reject one part of a contract and assume the rest. In a bank receivership, FDIC can bifurcate the respective assets and liabilities in a contract by rejecting the unfunded commitment on a construction loan and suing the borrower for funds advanced under the note prior to the date of the receivership.

FDIC uses its power to repudiate contracts frequently and in a number of different contexts. Borrowers frequently learn the hard way that their existing line of credit, construction loan facility or unsecured letter of credit at a failed bank is routinely rejected as of the receivership date. Vendors providing services to a failed bank can be abruptly terminated with little recourse. If, however, a vendor continues to provide the same services to the FDIC subsequent to the receivership, it may have a priority administrative claim under 12 U.S.C. 1821(e)(7)(B) and be paid for those services. Loan participation agreements and intercreditor agreements have previously been repudiated by FDIC although current FDIC policy seems to be not to reject such agreements with other FDIC insurance banks. See FDIC <u>Proposed Policy Statement on Participations</u>, 63 Federal Register 71926 (December 30, 1998)

(D) <u>Fraudulent Transfers</u>

FDIC, as receiver of a failed bank, has the ability to avoid certain fraudulent transfers. 12 U.S.C. §1821(d)(17)(A) allows FDIC to set aside a transfer of property made by a debtor or institution affiliated party of a failed bank made within 5 years of FDIC's appointment as receiver if the transfer was made with the intention of rendering, delaying or defrauding the failed bank or FDIC as its receiver.

(E) Preferences

Unlike the Bankruptcy Code which has provisions allowing a trustee in bankruptcy to avoid a preferential transfer to a creditor within 90 days of filing, the FDI Act has no similar provision to allow FDIC to avoid such a preferential transfer. This means that a depositor with uninsured deposits in excess of FDIC insurance limits can withdraw those funds the day before

or otherwise in anticipation of the bank's failure without risk of a "clawback" by FDIC as receiver.

(F) Recognition of Security Interests

The broad power granted to FDIC to repudiate contracts does not authorize it to set aside a lien given by a failed bank to a counterparty to secure a contractual obligation. 12 U.S.C. §1821(e)(11). Security interests granted to creditors of a failed bank are generally recognized unless the lien has been taken in contemplation of the bank's failure or for the purpose of hindering delaying or defrauding the failed bank or FDIC as its receiver.

(G) Setoff – Rights

Common law set off rights are determined under state law. The right to offset can be very valuable to holders of accounts at a failed bank with balances in excess of applicable FDIC insurance limits. If the respective debits and credits are mutual, the uninsured amount of a deposit at a failed bank can generally be offset against a performing loan the depositor owes the bank. This is a particularly important benefit to businesses which maintain large balance checking accounts and carry significant loan balances. FDIC is generally much more hospitable to offsets than trustees in bankruptcy. Set off rights, however, can be adversely affected if FDIC, as receiver, has transferred its loan asset to a bridge bank or third party but keeps the deposit liability or transfers it to a different party thereby destroying the reciprocal nature of the corresponding debts.

(H) <u>Acceleration Clauses</u>

12 U.S.C. §1821(e)(12) allows FDIC to enforce any contract (other than a qualified financial contract) with a so-called "ipso facto" clause purporting to terminate or accelerate the contract upon the failed bank's insolvency or receivership.

(I) Qualified Financial Contracts

A contract between a failed bank and a counterparty that meets the definition of a Qualified Financial Contract under 12 U.S.C. 1821(e)(8)(D) receives certain protections against the FDIC as receiver. Qualified Financial Contracts ("QFC") include a "securities contract, forward contract, repurchase agreement, swap agreement" or equivalent. The special protection (a) allows counterparties to a QFC with a failed bank to immediately enforce provisions in such agreement allowing the immediate termination and liquidation of the QFC and enforcement of set off and melting rights; (b) allows FDIC to dispose of QFC's only in a manner that will preserve the counterparty's cross-collateralization, set off and netting rights; and (c) gives the counterparty a more favorable measure of damages determined as of the actual date of repudiation (and not appointment of FDIC as receiver) and including cost of cover in the event FDIC repudiates a QFC.

(J) <u>Cross Guaranties from Affiliated Banks</u>

12 U.S.C. §1825(b)(3) allows FDIC to assess banks controlled by the same bank holding company for any losses FDIC incurs in a receivership of one of its affiliate banks. This allows FDIC to treat all of the banks in a multi-bank holding company as a single unit.

(K) Other FDIC Receivership Powers

(1) Taxes

12 U.S.C. §1825(b)(1) gives FDIC as receiver a partial immunity from state and local taxes except ad valorem real estate taxes.

(2) No attachment

12 U.S.C. §1825(b)(2) provides that no property of FDIC as receiver may be attached, levied or foreclosed upon without FDIC's consent and that no involuntary lien may attach to FDIC property.

(3) No penalties or filing fees

12 U.S.C. §1825(b)(3) provides that FDIC is exempt from recording and filing fees and excises. The FDIC does not pay recording fees, deed stamp excises or similar impositions.

V. FDIC Receivership Litigation "Superpowers".

The FDI Act grants FDIC a number of "superpowers" which it regularly uses to defeat both affirmative claims and defenses asserted by counterparties to the failed bank or FDIC as its receiver. While these superpowers are generally asserted in the context of litigation against FDIC, their use is not necessarily limited to the courtroom.

(A) <u>Improperly Documented or Side Agreement Not Binding Upon FDIC as</u> Receiver.

FDIC has three separate but related bases for avoiding improperly documented "side" agreements. These are (1) the federal common law <u>D'Oenche</u>, <u>Duhme</u> doctrine; (2) 12 U.S.C. §1823 (e) and 12 U.S.C §1821 (d)(9)(A), and (3) the federal common law holder in due course rule.

(1) The D'Oenche, Duhme Doctrine.

In <u>D'Oenche</u>, <u>Duhme & Co. v. FDIC</u>, 315 U.S. 447(1942), the United States Supreme Court held as a matter of federal common law that a side agreement not contained in the records of a failed bank could not serve as the basis of a defense to the FDIC's effort to collect an obligation owed to the failed bank. The rationale for the doctrine is that the FDIC, as receiver for a failed bank, must be able to rely on its books and records to evaluate its assets and liabilities accurately. Such reliance is critical in resolving the failed bank's affairs for a cost effective resolution transaction. Unless an agreement is properly documented in the failed bank's records.

it cannot be enforced against FDIC as receiver either to make a claim or to defend against a claim by FDIC. In <u>D'Oenche</u>, an argument made by an obligor on a promissory note that an undocumented, unrecorded side agreement changed or released the obligor's duty to repay the loan was barred. In 1997, FDIC issued a policy statement on the use of the <u>D'Oenche</u>, <u>Duhme</u> doctrine. See 62 <u>Federal Register</u> 5984 (February 10, 1997).

NOT

(2) <u>12 U.S.C § 1823(e)</u>.

12 U.S. Code § 1823(e) codified the <u>D'Oenche, Duhme</u> doctrine and provides that no agreement which tends to defeat or diminish the FDIC's interest in an <u>asset</u> is valid unless it: (i) is in writing; (ii) was executed by the failed bank and the person claiming an adverse interest under it contemporaneously with the acquisition of the asset (i.e. at the time of the loan was made); (iii) was approved by the board of directors or the loan committee of the failed bank, which approval is reflected in minutes kept by the failed bank; and (iv) has been continuously from time of execution an official record of the bank. Section 1823(e) also applies to assets acquired by FDIC in of a bridge bank. See 12 U.S.C §§ 1821(n)(7) and 1821(n)(4)(I). 12 U.S.C §1821(d)(9)(A) extends 12 U.S.C §1823(e) to <u>liabilities</u>. Reduced to its essence, 12 USC §§ 1821(d)(9)(A) and 1823(e) do allow a counterparty to an agreement to make a claim or defend against a claim by FDIC as receiver of a failed bank unless the agreement is properly documented in the bank's records.

(3) <u>Federal Common Law Holder in Due Course Rule.</u>

In addition to the <u>D'Oenche, Duhme</u> doctrine and 12 U.S.C §1823(e), the federal courts have developed a rule which grants FDIC the rights of a holder in due course (See <u>Gunter v. Hutcheson</u>, 674 F. 2nd 862 (11th Circuit 1981), <u>cert. den.</u> 459 U.S.C. 826 (1982). As holder in due course, FDIC takes promissory notes free of "personal" defenses. This holder in due course rule applies to FDIC as receiver or when FDIC acquires a note in its corporate capacity. The holder of a note acquired from FDIC can also utilize the holder in due course doctrine. Since the holder in due course doctrine is a matter of federal common law, FDIC is not required to meet state law requirements for holder in due course status.

(B) Prudential Mootness — Limitation on Liability

12 U.S.C. §1821(i) limits the liability of FDIC as receiver or in any other capacity to a claimant of a failed bank or its receivership to "the amount such claimant would have received if [FDIC] had liquidated the assets and liabilities of [the failed bank]." This provision can ban recovery of monetary damages against FDIC or receivership where it has determined that there will be no assets available for distribution to general, unsecured creditor of the receivership. It also discourages claimants from litigating against FDIC because any "upside" from a recovery will be reduced to the same percentage as other unsecured creditors receive.

(C) Litigation Stays.

12 U.S.C. §1821(d)(12) gives the FDIC as receiver authority to stay a judicial action or proceeding to which a failed bank is a party for up to ninety days.

(D) Federal Court Jurisdiction.

12 U.S.C §1819(b) gives the FDIC the right to remove any action or lawsuit from a state court to the federal court.

(E) Asset Freezes.

U.S.C §1821(d)(18) gives FDIC the authority to seek a court order to freeze the assets of any institution affiliated party prior to obtaining a judgment on the merits of its claims against that institution affiliated party. FDIC is not required to show irreparable or immediate injury as is required for private litigants.

(F) No Injunction Against FDIC.

12 U.S.C. §1821(j) prohibits courts from issuing injunctions to restrain FDIC as receiver from completing liquidation activities like conducting foreclosures or selling assets.

APPENDIX

- 1. K&L Gates Bank Regulatory Link Library (screen shot)
- 2. FDIC Statement of Policy on Exercise of D'Oench, Duhme Powers, dated February 10, 1997
- 3. FDIC Proposed Policy Statement Relative to Loan Participations, dated December 30, 1998
- 4. FDIC Policy Statement on Covered Bonds, dated July 28, 2008

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FEDERAL DEPOSIT INSURANCE CORPORATION

Statement of Policy Regarding Federal Common Law and Statutory Provisions Protecting FDIC, as Receiver or Corporate Liquidator, Against Unrecorded Agreements or Arrangements of a Depository Institution Prior to Receivership

AGENCY: Federal Deposit Insurance Corporation (FDIC).
ACTION: Statement.

SUMMARY: The FDIC has adopted a statement of policy which sets forth when the FDIC will assert the federal common-law doctrine enunciated by the Supreme Court in *D'Oench, Duhme & Co. v. FDIC,* 315 U.S. 447 (1942) and when the FDIC will assert the statutory protections set forth in 12 U.S.C. 1821(d)(9)(A) and 1823(e).

EFFECTIVE DATE: February 4, 1997.

FOR FURTHER INFORMATION CONTACT: Charlotte Kaplow, Counsel (202–736–0248), Legal Division, Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, D.C. 20429.

Introduction

The protection of the FDIC against unrecorded agreements or arrangements between a federally-insured depository institution (institution) and third parties is among the most important, longstanding, and powerful protections afforded the FDIC acting in either its corporate liquidator capacity (FDIC/ Corporate) or in its capacity as a receiver for a failed institution (FDIC/ Receiver). This statement of policy is intended to inform persons doing business with an institution of the circumstances in which: (1) The statutory provisions (12 U.S.C. 1821(d)(9)(A), 1823(e)); and (2) the rule enunciated by the Supreme Court in D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942), will be asserted by the FDIC to bar certain agreements or arrangements entered into with the institution prior to receivership. Published as an addendum are 'Guidelines For Use of D'Oench and Statutory Provisions" (Guidelines), which are discretionary and evolving by nature but nevertheless will serve to moderate the circumstances in which the FDIC will exercise these protections.

Background

More than fifty years ago, the Supreme Court in *D'Oench* first recognized a federal policy of protecting FDIC/Corporate from unrecorded schemes or arrangements that would tend to mislead banking authorities. The

Court articulated a rule of law prohibiting a party who had lent himself or herself to such a scheme or arrangement from asserting against the FDIC an unrecorded agreement. This rule of law, as it subsequently has been applied by the courts, is referred to as the "D'Oench doctrine".

In 1950, Congress enacted section 13(e), codified at 12 U.S.C. 1823(e) (section 1823(e)), as part of the Federal Deposit Insurance Act of 1950, ch. 967, Section 2[13](e), 64 Stat. 889 (81st Cong., 2d Sess. 1950). The strict approval and recording requirements of section 1823(e) supplemented the protection afforded by the D'Oench doctrine. In 1982, this section was reenacted by Congress as part of the Garn-St. Germain Depository Institution Act of 1982, Pub. L. 97-320, Section 113(m), 96 Stat, 1474, Both before and after 1982 the federal courts of appeals and federal district courts consistently construed section 1823(e) and the D'Oench doctrine in tandem.

In August 1989, as part of the Financial Institution Reform, Recovery and Enforcement Act (FIRREA), Public Law 101–73, 103 Stat. 183, Congress expanded section 1823(e) to cover defenses raised against the FDIC in its receivership capacity, the newly created Resolution Trust Corporation (in its corporate and receivership capacities) and bridge banks. In relevant part, section 1823(e) now provides:

No agreement which tends to diminish or defeat the interest of the [FDIC] in any asset acquired by it under this section or section 1821 of this title, either as security for a loan or by purchase or as receiver of any insured depository institution, shall be valid against the [FDIC] unless such agreement—

(A) Is in writing,

(B) Was executed by the depository institution and any person claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the depository institution,

(C) Was approved by the board of directors of the depository institution or its loan committee, which approval shall be reflected in the minutes of said board or committee, and

(D) Has been, continuously, from the time of its execution, an official record of the depository institution.

12 U.S.C. 1823(e)

In addition, FTRREA added a new provision, section 11(d)(9)(A) (codified at 12 U.S.C. 1821(d)(9)(A) (section 1821(d)(9)(A)), which states, in relevant part, that "any agreement which does not meet the requirements set forth in

section 1823(e) * * * shall not form the basis of, or substantially comprise, a claim against the receiver or the [FDIC in its corporate capacity]."

In the FDIC's view, Congress intended that sections 1823(e) (as amended by FIRREA) and 1821(d)(9)(A) should be interpreted in a manner consistent with the policy concerns underlying the D'Oench doctrine. Accordingly, subject to the Guidelines, these sections bar claims that do not meet the enumerated recording requirements set forth in section 1823(e), regardless of whether a specific asset is involved, to the same extent as such claims would be barred by the D'Oench doctrine.

More specifically, the statutory definition of the scope of agreements to which section 1823(e) applies—i.e., those agreements "which tend[] to diminish or defeat the interest of the [FDIC] in any asset acquired by it" (section 1823(e))—is not a "requirement" that section 1823(e) imposes on those agreements, which if not "met" renders section 1821(d)(9) inapplicable. There is no reason to suppose that Congress intended the scope of section 1821(d)(9)(A) to be coextensive with that of section 1823(e).

Section 1823(e) applies only with respect to agreements that pertain to assets held by the FDIC because the function of that section is to bar certain defenses to the FDIC's collection on such assets. Section 1821(d)(9)(A)'s function, in contrast, is to bar certain affirmative claims against the FDIC. It does so in order to affect primary conduct by providing an incentive for parties contracting with institutions to document their transactions thoroughly. That in turn: (1) Allows federal and state bank examiners to rely on an institution's records in evaluating its worth; and (2) ensures mature consideration of unusual banking transactions by senior bank or thrift officials and prevents the fraudulent insertion of new terms when an institution appears headed for failure. Cf. Langley v. FDIC, 484 U.S. 86, 91-92

In interpreting the meaning of "agreement" in section 1823(e) prior to its amendment in 1989, the Supreme Court in Langley held that it would disserve the policies recognized in D'Oench to interpret section 1823(e) in a more restricted manner than D'Oench itself: "We can safely assume that Congress did not mean 'agreement' in section 1823(e) to be interpreted so much more narrowly than its permissible meaning as to disserve the

¹ The Guidelines have been in effect since late 1994.

principle of the leading case applying that term to FDIC-acquired notes." Langley, 484 U.S. at 92–93. In the same way, it would disserve the policies recognized in D'Oench and Langley to interpret section 1821(d)(9)(A) more narrowly than D'Oench has been applied in so-called no-asset cases.²

Nevertheless, as reflected in the Guidelines, the FDIC, as a matter of policy, will not seek to bar claims which by their very nature do not lend themselves to the enumerated requirements of section 1823(e). To that end, the FDIC will continue to assert the protections of the *D'Oench* doctrine and FIRREA (sections 1821(d) (9)(A), 1823(e)) only in accordance with the Guidelines.

The FDIC has also determined, after careful consideration, that sections 1823(e) (as amended by FIRREA) and 1821(d)(9)(A) cannot be applied retroactively to alleged agreements or arrangements entered into before the enactment of FIRREA on August 9, 1989. Following the Supreme Court's decision in Landgraf v. USI Film Products, 511 U.S. 244, 114 S. Ct. 1483 (1994), the courts of appeals that have addressed the issue have concluded that sections 1821(d)(9) and 1823(e) (as amended by FIRREA) do not apply in cases where the transactions at issue occurred before FIRREA's enactment.3

No provision within FIRREA addresses the temporal reach of section 1821(d)(9) or section 1823(e)(as amended by FIRREA). If the courts were to apply those provisions to agreements made before the statute was enacted, that would alter the rights possessed by the parties to such agreements. Under the principles articulated by the Supreme Court in Landgraf, Congress must therefore be presumed to have intended for those provisions to apply

only with respect to agreements made after the enactment of FIRREA.⁵ Thus, because the statutory provisions establish "a categorical recording scheme" (see *Langley*, 484 U.S. at 95) and *D'Oench* is an equitable doctrine (id. 93–95), sections 1821(d)(9)(A) and 1823(e) (as amended by FIRREA) cannot be applied retroactively.

Accordingly, the statement of policy announces that the FDIC will assert the D'Oench doctrine for pre-FIRREA claims to the extent section 1823(e) (as it existed prior to FIRREA) is inapplicable but the claim nevertheless runs afoul of the D'Oench doctrine. For claims that relate to agreements or arrangements entered into after the effective date of FIRREA, the FDIC will apply only sections 1823(e) (as amended by FIRREA) and section 1821(d)(9)(A) to bar claims not entered into in accordance with the enumerated requirements of section 1823(e) (as amended by FIRREA). In either case, these protections will be asserted only in keeping with the Guidelines.

FDIC Statement of Policy

- 1. Because sections 1821(d)(9)(A) and 1823(e) (as amended by FIRREA) do not apply to agreements entered into before the effective date of FIRREA (August 9, 1989), such agreements are governed by pre-FIRREA law, including section 1823(e) and the *D'Oench* doctrine.
- 2. Agreements made after the enactment of FIRREA are governed by sections 1821(d)(9)(A) and 1823(e) (as amended by FIRREA).
- 3. This statement of policy does not supersede the FDIC's Statement of Policy Regarding Treatment of Security Interests After Appointment of the FDIC as Conservator or Receiver of March 23, 1993 (58 FR 16833).

By order of the FDIC Board of Directors. Dated at Washington, DC, this 4th day of February, 1997.

Federal Deposit Insurance Corporation. Jerry L. Langley, Executive Secretary.

Addendum—FDIC Guidelines for Use of D'Oench and Statutory Provisions

1. *Purpose.* To set forth guidelines for the use of the *D'Oench* doctrine and in

12 U.S.C. 1821(d)(9)(A), 1823(e) (statutory provisions).

2. Scope. This directive applies to all Service Centers and Consolidated Offices, to all future Servicers and, to the extent feasible, to all current Servicers.

3. Responsibility. It is the responsibility of the FDIC Regional Directors of the Division of Resolutions and Receiverships (DRR) and Regional Counsel of the Legal Division (Legal) to ensure compliance with applicable directives by all personnel in their respective service centers.

4. Background

a. D'Oench Doctrine

In an effort to protect the federal deposit insurance funds and the innocent depositors and creditors of insured financial institutions (institution(s)), the Supreme Court in the case of *D'Oench*, *Duhme & Co.* v. *FDIC*, 315 U.S. 447 (1942) adopted what is commonly known as the *D'Oench* doctrine. This legal doctrine provides that a party who lends himself or herself to a scheme or arrangement that would tend to mislead the banking authorities cannot assert defenses and/or claims based on that scheme or arrangement.

b. Sections 1821(d)(9)(A) and 1823(e)

In 1950, Congress supplemented the D'Oench doctrine with 12 U.S.C. 1823(e) which bars any agreement which "tends to diminish or defeat the interest of the [FDIC] in any asset unless the agreement satisfies all four of the following requirements: (1) It is in writing; (2) it was executed by the depository institution and any person claiming an adverse interest under the agreement contemporaneously with the acquisition of the asset; (3) it was approved by the board of directors of the institution or its loan committee as reflected in the minutes of the board or committee; and (4) it has been continuously an official record of the institution.

In FIRREA, Congress added 12 U.S.C. 1821(d)(9)(A) which protects the FDIC against all claims which do not meet the enumerated requirements of section 1823(e).

c. Policy Considerations

The D'Oench doctrine and the statutory provisions embody a public policy designed to protect diligent creditors and innocent depositors from bearing the losses that would result if claims and defenses based on undocumented agreements could be enforced against a failed institution. The requirement that any arrangement or agreement with a failed institution must

²Two courts of appeals have applied section 1821(d)(9)(A) in a more constricted manner. See John v. RTC. 39 F.3d 773, 776 (7th Cir. 1994); and Thippen v. Sparks, 983 F.2d 644 (5th Cir. 1993). Both of these cases involved pre-FIRREA facts and. consequently, as discussed infra. sections 1821(d)(9)(A) and 1823(e) (as amended by FIRREA) were inapplicable. Moreover, in any future case involving similar post-FIRREA facts, any decision to raise the statutory protections would have to be authorized pursuant to the Guidelines, which were not in use at the time these cases were litigated.

³ See Oklahoma Radio Assocs. v. FDIC, 987 F 2d 685, 695–96, motion to vacate denied, 3 F.3d 1436 (10th Cir. 1993); Murphy v. FDIC, 38 F 3d 1490, 1501 (9th Cir. 1994) (en banc) (noting FDIC's concession in that regard).

⁴ Before FIRREA, a borrower could assert an affirmative claim against the FDIC or FSLIC, or a defense against FDIC/Receiver or the FSLIC, based on a written agreement that failed to meet the contemporaneous-execution, approval, and recording requirements of section 1823(e), so long as the borrower had not lent himself to an arrangement or scheme likely to mislead bank examiners. D'Oench, 315 U.S. at 460

⁵The retroactivity of FIRREA, however, is not determined on an all-or-nothing basis. There is no "reason to think that all the diverse provisions of the [statute] must be treated uniformly for purposes of the retroactivity analysis. Landgraf v. USI Film Prods., 511 U.S. at 280, 114 S. Ct. at 1505 Moreover, "I(lhe conclusion that a particular rule operates 'retroactively' comes at the end of a process of judgment concerning the nature and extent of the change in the law and the degree of connection between the operation of the new rule and a relevant past event." Landgraf, 511 U.S. at 270, 114 S. Ct. at 1499.

be in writing allows banking regulators to conduct effective evaluations of open institutions and the FDIC to accurately and quickly complete resolution transactions for failed institutions. This requirement also places the burden of any losses from an undocumented or "secret" arrangement or agreement on the parties to the transaction, who are in the best position to prevent any loss.

Although the D'Oench doctrine and the statutory provisions generally promote essential public policy goals, overly aggressive application of the specific requirement of these legal doctrines could lead to inequitable and inconsistent results in particular cases. In order to ameliorate this possibility, the FDIC has undertaken development of these guidelines and procedures to promote the exercise of sound discretion in the application of D'Oench or the statutory provisions.

5. Guidelines

These guidelines are intended to aid in the review of matters where the assertion of D'Oench or the statutory provisions is being considered. The examples given are intended to give clear direction as to when particular issues must be referred. In particular, if the use of D'Oench or the statutory provisions is proposed in a DRR-Operations matter within the categories set forth below, the matter and recommendation must be referred to the Associate Director—Operations for approval through the procedures contained in section 6.

In the great majority of cases, however, it is anticipated that no resort to Washington should be necessary. It is only in the categories of cases highlighted in the guidelines that Washington approval must be obtained.

a. Pre-Closing Vendors

D'Oench or the statutory provisions shall not be used as a defense against claims by vendors who have supplied goods and/or services to failed institution pre-closing when there is clear evidence that the goods/services were received. In such case, D'Oench or the statutory provisions shall not be asserted whether or not there are written records in the institution's files confirming a contract for the goods and/ or services.

This does not mean that D'Oench or the statutory provisions may never be asserted against a vendor, but only that each claim must be examined carefully on its facts. When there is no evidence that goods or services were received by the failed institution or in other appropriate circumstances, the defenses may be asserted after approval by Washington.

Examples Requiring Washington Approval:

1. Landscaping service filed claim for planting trees around the institution's parking lot. There is no contract for planting trees in the books and records of the institution, but there are trees around the parking lot and no record of any payment. In this example, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

2. A contingency fee attorney is unable to produce any contingency fee agreement, but there is evidence in the files that this attorney has been paid for his collection work for the past 20 years and his name appears on the court records for collection matters for which he has not been paid. In this example also, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

3. Contractor has construction contract with institution to renovate any property owned by the institution. At the time the institution fails, the contractor has completed 90% of the contract and is owed about 50% of the contract price. Here too, Washington approval must be obtained before asserting \vec{D} Oench or the statutory provisions.

b. Diligent Party

D'Oench or the statutory provisions may not be asserted without Washington approval where the borrower or claimant took all reasonable steps to document and record the agreement or understanding with the institution and there is no evidence that the borrower or claimant participated in some activity that could likely result in deception of banking regulators, examiners, or the FDIC regarding the assets or liabilities of the institution. In particular, Washington approval is required before D'Oench or the statutory provisions may be asserted where the agreement is not contained in the institution's records, but where the borrower or claimant can establish by clear and convincing evidence that the agreement was properly executed by the depository institution through an officer authorized by the board of directors to execute such agreements, as reflected in the minutes of the board. Cases involving "insiders" of the depository institution require particularly careful review because of the greater opportunities of such parties to manipulate the inclusion of 'agreements" within the institution's records.

Further, where it is clear that a borrower or claimant has been diligent in insisting on a written document in an apparently arms-length transaction, and had no control over the section 1823(e) requirement that the transaction be reflected in the Board of Directors' or

Loan Committee minutes, assertion of the statutory provisions solely because the transaction is not reflected in those minutes may not be appropriate. In such cases, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

Examples Requiring Washington Approval:

1. Plaintiff sells a large parcel of land to the borrower of the failed institution and the property description in the failed institution's Deed of Trust mistakenly includes both the parcel intended to be sold and a parcel of property not included in the sale. Prior to the appointment of the receiver, the institution agrees orally to amend the Deed of Trust, and indeed sends a letter to the title company asking for the amendment. However, there is nothing in the books and records of the institution to indicate the mistake. The institution fails and the Deed of Trust has never been amended. The borrower defaults and the FDIC attempted to foreclose on both parcels. In this example, Washington approval must be obtained before asserting 'Oench or the statutory provisions.

2. A limited partnership applies for refinancing. A commitment letter is issued by the institution to fund a non-recourse permanent loan which requires additional security of \$1 million from a non-partner. The Board of Directors minutes reflects that approval is for a nonrecourse loan, however, the final loan documents, including the note, do not contain the nonrecourse provisions. The institution fails, the partnership defaults and it is determined that the collateral plus the additional collateral is approximately \$3 million less than the balance of the loan. In a suit by the FDIC for the deficiency, Washington approval must be obtained before asserting D'Oench or the statutory

provisions.

3. A borrower completes payment on a loan, and he has cancelled checks evidencing that his loan has been paid off. The institution's records, however, do not document that the final payment has been tendered. The institution fails and the FDIC seeks to enforce the note. Washington approval must be obtained before asserting D'Oench or the statutory provisions.

However, if it is clear that the borrower or claimant participated in some fraudulent or other activity which could have resulted in deception of banking regulators or examiners, then D'Oench or the statutory provisions may be asserted without prior approval from Washington.

Examples Not Requiring Washington Approval:

1. Borrower signs a note with several blanks including the amount of the loan. An officer of the institution fills in the amount of the loan as \$40,000. Bank fails, loan is in default, the FDIC sues to collect \$40,000 and the borrower claims that he or she only borrowed \$20,000. There is nothing in the institution's books and records to indicate the \$20,000 amount, and, in fact, the institution's books and records evidence

disbursement of \$40,000. D'Oench or the statutory provisions may be asserted.

2. Guarantor, an officer of the borrower corporation, signs a guaranty for the entire amount of a loan to the corporation. At the time of the institution's failure, the loan is in default and the corporation is in Chapter 7 bankruptcy. FDIC files suit against the guarantor for the entire amount of the loan. The guarantor claims that he has an agreement with the institution that he is only liable for the first \$25,000. There is no record in the institution's files of such an agreement. Again, D'Oench or the statutory provisions may be asserted.

Where the specific facts of a case raise any question as to whether *D'Oench* or the statutory provisions should be asserted, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

c. Integral Document

If there are documents in the books and records of the institution which indicate an agreement under the terms asserted by the claimant or borrower, the use of *D'Oench* or the statutory provisions must be carefully evaluated. Particular care must be taken before challenging a claim or defense solely because it fails to comply with the 1823(e) requirement that the agreement be reflected in the minutes of the Board of Directors or Loan Committee. While any number of cases have held that the terms of the agreement must be ascertainable on the face of the document, in some circumstances it may be appropriate to consider all of the failed institution's books and records in determining the agreement, not just an individual document. Where the records of the institution provide satisfactory evidence of an agreement, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

Examples Requiring Washington Approval:

1. Note in failed institution's file is for one year term on its face. However, the loan application, which is in the loan file, is for five years renewable at one year intervals. The borrower also produces a letter from an officer of the institution confirming that the loan would be renewed on a sixty month basis with a series of one year notes. In this example, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

2. Debtor executes two notes with the proviso that there is no personal liability to the debtor beyond the collateral pledged. When the notes become due they are rolled over and consolidated into one note which recited that it is a renewal and extension of the original notes but does not contain the express disclaimer of personal liability. All three notes are contained together in one loan file. Here, all of the notes should be considered as part of the institution's

records. In this example also, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

d. No Asset/Transactions Not Recorded in Ordinary Course of Business

The use of D'Oench or the statutory provisions should be limited in most circumstances to loan transactions and other similar ordinary banking transactions. If the ordinary banking transaction is not related to specific current or former assets, Washington approval must be obtained before asserting D'Oench or the statutory provisions in such cases. The application of D'Oench or the statutory provisions also should be carefully considered before it is asserted in opposition to a tort claim, such as negligence, misrepresentation or tortious interference with business relationships, where the claim is unrelated to a loan or ordinary banking transaction or to a transaction creating or designed to create an asset. Washington approval must be obtained before asserting D'Oench or the statutory provisions in such cases.

Examples Requiring Washington Approval:

1. Three years before failure the institution sells one of its subsidiaries. The institution warrants that the subsidiary has been in "continuous and uninterrupted status of good standing" through the date of sale. The buyer in turn attempts to sell the subsidiary and discovers that the subsidiary's charter has been briefly forfeited. The prospective buyer refuses to go through with the sale and the original buyer sues the institution for breach of warranty. FDIC is appointed receiver. This transaction does not involve a lending or other banking financial relationship between the institution and the buyer. In addition, the subsidiary is not an asset on the books of the institution at the time of the receivership. In this example, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

2. In the case described above in the diligent party section, where the property description in the failed institution's Deed of Trust mistakenly includes a parcel not included in the sale, the parcel at issue is not an actual asset of the failed institution and the assertion of *D'Oench* or the statutory provisions is not be appropriate. Here too, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

However, if a claim arises out of an asset which was involved in a normal banking transaction, such as a loan, *D'Oench* or the statutory provisions would be properly asserted against such a claim despite the fact that the asset no longer exists. For example, collection on the asset does not preclude the use of *D'Oench* or the statutory provisions in

response to claims by the former debtor related to the transaction creating the asset.

Example Not Requiring Washington Approval:

1. A borrower obtains a loan from an institution, secured by inventory and with an agreement that allows the institution to audit the business. The business fails, the institution sells the remaining inventory, and applies the proceeds of the sale to the business's debt. Borrower sues the institution for breach of oral agreements, breach of fiduciary duty, and negligence in performance of audits of the business. Borrower then pays off remaining amount of loan and continues the lawsuit. The institution subsequently fails. Despite borrower's argument that there is no asset involved since the debt has been paid, assertion of D'Oench or the statutory provisions would be appropriate.

e. Bilateral Obligations

The facts must be examined closely in matters where the agreement which the FDIC is attempting to enforce contains obligations on both the borrower or claimant and the failed institution and the borrower or claimant is asserting that the institution breached the agreement. If the failed institution's obligation is clear on the face of the agreement and there are documents supporting the claimed breach which are outside the books and records of the institution, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

f. Statutory Defenses

The appropriateness of using D'Oench or the statutory provisions to counter statutory defenses should be evaluated on a case by case basis. Although many such defenses may be based on an agreement that is not fully reflected in the books and records of the institution, a careful analysis should be made before asserting D'Oench or the statutory provisions. In such cases, Washington approval must be obtained before asserting D'Oench or the statutory provisions.

The clearest examples of situations where assertion of *D'Oench* or the statutory provisions may be appropriate occur where the opposing party is relying on a statutory defense based upon some misrepresentation or omission by the failed institution. Examples of this type of statute are unfair trade practice statutes.

On the other hand, application of *D'Oench* or the statutory provisions may not be appropriate to oppose claims based on mechanics lien statutes or statutes granting other recorded property rights. The fact that all elements of those liens may not be

reflected in the books and records of the institution should not control the application of *D'Oench* or the statutory provisions.

In analyzing the propriety of asserting the *D'Oench* or the statutory provisions, at least the following three general factors should be considered in preparation for seeking approval from Washington:

- * To what extent is the purpose of the statute regulatory, rather than remedial? If the statute simply imposes regulatory or mandatory requirements for a transaction, such as a filing requirement or maximum fee for services, assertion of *D'Oench* or the statutory provisions is unlikely to be successful.
- * To what extent is the application of the statute premised upon facts that are not reflected in the books and records of the institution? If the state statute requires the existence and/or maintenance of certain facts, but those facts are not recorded in the institution's records, then *D'Oench* or the statutory provisions may be applicable.
- * To what extent do the facts involve circumstances where the opposing party failed to take reasonable steps to document some necessary requirement or participated in some scheme or arrangement that would tend to mislead the banking authorities.

Examples Requiring Washington Approval:

- I. A priority dispute arises involving a mechanic's lien against property on which the FDIC is attempting to foreclose. An attempt to persuade a court that the mechanic's lien is a form of secret agreement under *D'Oench*, which, if given priority over the interests of the FDIC, will tend to diminish or defeat the value of the asset may not be appropriate. In this example, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.
- 2. State law requires insurance companies doing business in the state to deposit funds with the Commissioner of Insurance. Further, the law provides that the deposit cannot be levied upon by creditors or claimants of the insurance company. An insurance company purchases a certificate of deposit from an institution and assigns it to the Commissioner. At the same time a document is executed entitled "Requisition to the Bank" which states that the institution would not release the CD funds without authorization of the Commissioner Subsequently the insurance company borrows money from the institution. After the loan goes into default, the institution does not roll the CD over, but rather credits the proceeds to the loan account. The institution then fails and the Commissioner files a proof of claim with the FDIC seeking payment on the CD. The FDIC may not defend the suit by claiming that the assignment documents did not meet the requirements of section 1823(e) In this example, Washington approval must be obtained before asserting D'Oench or the statutory provisions.
- 3. The FDIC attempts to collect on a note which the failed institution acquired from a

mortgage broker. The note is at a 15% interest rate and the mortgage broker charged six and one half points. State law provides that interest shall be no more than 13% and that no more than one point may be charged. The FDIC may not defend the borrower's counterclaim of a usurious loan by asserting *D'Oench* or the statutory provisions. Here too, Washington approval must be obtained before asserting *D'Oench* or the statutory provisions.

g. Section 1823(e)'s Contemporaneous Requirement

This requirement of section 1823(e) may not be asserted to invalidate a good faith workout or loan modification agreement where the sole issue is whether the contemporaneous requirement of section 1823(e) is met. Where there is an agreement which otherwise satisfies the remaining requirements of the statute, but was not executed contemporaneously with the acquisition of the asset, in most circumstances the statutory provisions should not be asserted. This applies only to workouts or loan modifications done by the failed institution prior to receivership. The assertion of the section 1823(e) contemporaneous requirement should be considered principally where the facts demonstrate that the workout or restructure was entered into in bad faith and in anticipation of institution failure.

Washington approval must be obtained before asserting *D'Oench* or the statutory provisions in these cases.

6. Procedures To Obtain Washington Approval

DRR Operations: When facts involving the possible assertion of D'Oench or the statutory provisions arise, Legal should be consulted. When the assertion of D'Oench or statutory provisions requires Washington approval, as outlined above, prior approval must be received from the Deputy Director—Operations or his designee in Washington in all such cases. Such approval must be obtained by preparation of a memorandum identifying the facts of the case forwarded through Legal Division procedures to the Deputy Director-Operations or his designee.

DRR Asset Management: When facts involving the possible assertion of *D'Oench* or the statutory provisions arise, Legal should be consulted. When the assertion of *D'Oench* or the statutory provisions requires Washington approval, as outlined above, Legal Division procedures should be followed for referral to Washington. Washington Legal will consult with Washington DRR where appropriate.

Legal: Each attorney must carefully review the facts of each instance where the assertion of *D'Oench* or the statutory provisions is being considered under revised Litigation Procedure 3 (LP 3). All cases requiring consultation or approval within these Guidelines and/or PS must be referred to Washington pursuant to LP3 procedures.

These Guidelines are intended only to improve the FDIC's review and management of utilization of D'Oench or the statutory provisions. The Guidelines do not create any right or benefit, substantive or procedural, that is enforceable at law, in equity, or otherwise by any party against the FDIC, its officers, employees, or agents, or any other person. The Guidelines shall not be construed to create any right to judicial review, settlement, or any other right involving compliance with its terms.

[FR Doc. 97-3190 Filed 2-7-97; 8:45 am]

FEDERAL MARITIME COMMISSION [Docket No. 97-02]

McKenna Trucking Company, Inc. v. Maersk Incorporated; Notice of Filing of Complaint and Assignment

Notice is given that a complaint filed by McKenna Trucking Company, Inc. ("Complainant") against Maersk Incorporated ("Respondent") was served February 5, 1997. Complainant alleges that Respondent has violated sections 10(b)(1), (4), (6), (10), (11), and (12) of the Shipping Act of 1984, 46 U.S.C. app. sections 1709(1), (4), (6), (10), (11), and (12), by receiving rebates of intermodal trucking charges, thereby charging, demanding, collection and receiving greater compensation for the transportation of property than the rates shown in its service contracts, and subjecting complainant to an unreasonable refusal to deal, while continuing to charge shippers the higher, listed rate as a portion of the total through rate.

This proceeding has been assigned to the Office of Administrative Law Judges. Hearing in this matter, if any is held, shall commence within the time limitations prescribed in 46 CFR 502.61, and only after consideration has been given by the parties and the presiding officer to the use of alternative forms of dispute resolution. The hearing shall include oral testimony and cross-examination in the discretion of the presiding officer only upon proper showing that there are genuine issues of material fact that cannot be resolved on

use of special characters and any form of encryption. Comments and data will also be accepted on disks in WordPerfect in 5.1/6.1 or ASCII file format. All comments and data in electronic form must be identified by the docket control numbers OPP-00559 or OPP-00560. Electronic comments on this proposed rule may be filed online at many Federal Depository Libraries.

List of Subjects

Environmental protection, Administrative practice and procedure, Agricultural commodities, pesticides and pests.

Dated: December 21, 1998.

Lynn R. Goldman

Assistant Administrator for Prevention, Pesticides and Toxic Substances

[FR Doc. 98–34429 Filed 12–29–98; 8:45 am] BILLING CODE 6560–50–F

FEDERAL DEPOSIT INSURANCE CORPORATION

Repudiation and Asset-backed Securitizations and Loan Participations

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Proposed statement of policy.

SUMMARY: In response to inquiries from insured depository institutions, accountants, and other parties involved in asset-backed securitizations and loan participations, the Board of Directors of the FDIC (Board) is proposing to adopt a Statement of Policy Regarding Treatment of Securitizations and Loan Participations After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver (Statement of Policy) to clarify how the FDIC will treat securitizations and loan participations in its role as conservator or receiver of insured depository institutions. The proposed Statement of Policy provides that subject to certain conditions, the FDIC will not attempt to reclaim. recover, or recharacterize as property of the institution or the receivership estate in the case of a securitization, the financial assets transferred by the insured depository institution to a special purpose entity in connection with the securitization, or in the case of a loan participation, the undivided interest transferred to a participant in connection with the loan participation. It is anticipated that the proposed Statement of Policy would provide helpful guidance to insured depository institutions, accountants, and other

parties involved in securitizations and loan participations.

DATES: Comments must be received by March 1, 1999.

ADDRESSES: Send written comments to Robert E. Feldman, Executive Secretary, Attention: Comments/OES, Federal Deposit Insurance Corporation, 550 17th Street NW, Washington, DC 20429. Comments may be hand delivered to the guard station located at the rear of the 17th Street building (located on F Street), on business days between 7:00 a.m. and 5:00 p.m. (FAX number (202) 898-3838; Internet address: comments@fdic.gov. Comments may be inspected and photocopied at the FDIC Public Information Center, Room 100, 801 17th Street NW, Washington, DC, on business days between 9:00 a.m. and 4:30 p.m.

FOR FURTHER INFORMATION CONTACT: Michael H. Krimminger, Senior Policy Analyst, Office of Policy Development, (202) 898-8950; Robert Storch, Chief. Accounting Section, Division of Supervision, (202) 898-8906; Thomas Bolt, Counsel, Legal Division, (202) 736-0168; Federal Deposit Insurance Corporation, Washington, D.C. 20429. SUPPLEMENTARY INFORMATION: Under section 11(e)(1) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(e)(1), the FDIC, as conservator or receiver of any insured depository institution, may repudiate any contract entered into by the institution before appointment of the conservator or receiver. Insured depository institutions, accountants, and other parties involved in assetbacked securitizations and loan participations have raised questions about whether the repudiation of a securitization or loan participation by the FDIC would result in the FDIC's recovery of the transferred financial assets, in the case of a securitization, or the undivided interest in a loan, in the case of a loan participation. If so, transfers of such assets or interest by insured depository institutions would likely not be accounted for as a sale under generally accepted accounting principles, which require that transferred assets be placed beyond the reach of the transferor, its creditors, or a receiver for the transferor, in order for the transfer to be accounted for as a sale.

The FDIC is considering whether to adopt the proposed Statement of Policy to provide guidance as to its treatment of securitizations and loan participations after its appointment as conservator or receiver of an insured depository institution. The proposed Statement of Policy provides that subject to certain conditions, the FDIC will not attempt to reclaim, recover, or

recharacterize as property of the institution or the receivership estate (i) in the case of a securitization, the financial assets transferred by the insured depository institution to a special purpose entity in connection with the securitization, or (ii) in the case of a loan participation, the undivided interest transferred to a participant in connection with the loan participation.

The proposed Statement of Policy applies only to securitizations and loan participations where (i) the criteria for sale accounting under generally accepted accounting principles have been satisfied (including the legal isolation test, as affected by the proposed Statement of Policy); (ii) the documentation effecting the transfer of financial assets, in the case of a securitization, or undivided interest in a loan, in the case of a loan participation, reflects the intent of the parties to treat the transaction as a sale, and not as a secured borrowing (without regard to the intended treatment of the transaction for tax purposes); and (iii) the institution received adequate consideration for the transfer at the time it was made.

The proposed Statement of Policy is set forth below. Comment is invited on all aspects of the proposal, including whether, after adoption of the Statement of Policy by the FDIC, the transfer of financial assets in connection with a securitization and the transfer of an undivided interest in a loan in the form of a loan participation by an insured depository institution would be accounted for as a sale under generally accepted accounting principles.

The Statement of Policy proposed by

The Statement of Policy proposed by the Board reads as follows:

Statement of Policy Regarding Treatment of Securitizations and Loan Participations After Appointment of the Federal Deposit Insurance Corporation as Conservator or Receiver

This Statement of Policy is issued by the Federal Deposit Insurance Corporation (FDIC) to clarify the treatment of securitizations and loan participations after appointment of the FDIC as conservator or receiver of an insured depository institution.

I. Definitions

As used in this Statement of Policy, the following terms have the following meanings:

A. "Beneficial interest" means debt or equity (or mixed) interests or obligations issued by a special purpose entity that entitle their holders to receive payments that depend primarily on the cash flow from financial assets owned by the special purpose entity.

B. "Financial asset" means cash or a contract or instrument that conveys to one entity a contractual right to receive cash or another financial instrument from another entity. Financial assets may include, but are not limited to, residential and commercial mortgage loans, commercial and industrial loans, consumer receivables, trade receivables, lease receivables, securities, and obligations satisfying the definition of "permitted assets" for purposes of Section 860L (c) of the Internal Revenue Code of 1986, as amended.

C. "Loan participation" means the transfer of an undivided interest in all or part of the principal amount of a loan from a seller, known as the "lead", to a buyer, known as the "participant", without recourse to the lead, pursuant to an agreement between the lead and the participant. "Without recourse" means that the loan participation is not subject to any agreement that requires the lead to repurchase the participant's interest or to otherwise compensate the participant upon the borrower's default on the underlying loan. Use of the singular in this definition is intended to refer also to loan participations that involve more than one loan or more than one buyer.

D. "Securitization" means the issuance by a special purpose entity of beneficial interests, the most senior class of which at time of issuance is rated investment grade by one or more nationally recognized statistical rating organizations, or which are sold in transactions by an issuer not involving any public offering for purposes of Section 4 of the Securities Act of 1933.

E. "Special purpose entity" means a trust, corporation, or other entity with distinct standing at law from the insured depository institution that is primarily engaged in acquiring and holding (or transferring to another special purpose entity) financial assets (or participations or other interests therein), and in activities related or incidental thereto, in connection with the issuance by such special purpose entity (or by another special purpose entity that acquires financial assets directly or indirectly from such special purpose entity) of beneficial interests.

II. Background

Under generally accepted accounting principles, one of the criteria for a transfer of financial assets to be accounted for as a sale is the 'legal isolation' of the transferred assets. Assets are deemed to be legally isolated when they have been placed beyond the reach of the transferor and its creditors, even in the case of a bankruptcy or appointment of a receiver for the

transferor. Accountants, auditors, and other parties have raised concerns whether the legal isolation test would be satisfied in the case of a transfer of financial assets by an insured depository institution in connection with a securitization, or the transfer of an interest in a loan by such institution in the form of a loan participation, in light of the statutory power of the FDIC as conservator or receiver to repudiate contracts entered into by such institution. Specifically, questions have been raised about whether the repudiation of a securitization or loan participation by the FDIC would result in the FDIC's recovery of the transferred financial assets, in the case of a securitization, or the undivided interest in a loan, in the case of a loan participation. As guidance for parties who may encounter this issue, the FDIC has resolved to issue this statement of policy to clarify the effect of its statutory repudiation power on securitizations and loan participations.

Pursuant to Section 11(e)(1) of the Federal Deposit Insurance Act, 12 U.S.C. 1821(e)(1), the FDIC, when acting as conservator or receiver of any insured depository institution, has the power to disaffirm or repudiate any contract or lease (i) to which the institution is a party, (ii) the performance of which the conservator or receiver, in the conservator's or receiver's discretion, determines to be burdensome, and (iii) the disaffirmance or repudiation of which the conservator or receiver determines, in the conservator's or receiver's discretion, will promote the orderly administration of the institution's affairs. Repudiation of a contract relieves the FDIC from performing any unperformed obligations remaining under the contract and entitles the other party to the contract to a claim for damages. Such damages are limited by statute to actual direct compensatory damages determined as of the date of the appointment of the conservator or receiver.

The FDIC may exercise its statutory power to repudiate any contract entered into by the institution, including agreements entered into in connection with securitizations or loan participations. In order to resolve issues raised about the effect of this statutory power on such transactions, the FDIC has determined that, if certain conditions are met, it will not seek to reclaim, recover, or recharacterize as property of the institution or the receivership estate the financial assets or undivided interest in a loan transferred by the institution in connection with a securitization or loan participation, respectively. Accordingly, the FDIC makes the following Statement of Policy, which is intended to be of binding effect upon the FDIC in all instances in which it is appointed as conservator or receiver of an insured depository institution.

III. Statement of Policy

Subject to the following conditions, the FDIC will not attempt to reclaim, recover, or recharacterize as property of the institution or the receivership estate (i) in the case of a securitization, the financial assets transferred by the insured depository institution to a special purpose entity in connection with the securitization, or (ii) in the case of a loan participation, the undivided interest transferred to a participant in connection with the loan participation.

IV. Conditions

A. This Statement of Policy addresses only the exercise of the FDIC's statutory repudiation power with respect to securitizations and loan participations.

B. This Statement of Policy applies only to those securitizations or loan participations where the criteria for sale accounting under generally accepted accounting principles have been satisfied (including the legal isolation test, as affected by this Statement of Policy); the documentation effecting the transfer of financial assets, in the case of a securitization, or undivided interest in a loan, in the case of a loan participation, reflects the intent of the parties to treat the transaction as a sale, and not as a secured borrowing (without regard to the intended treatment of the transaction for tax purposes); and the institution received adequate consideration for the transfer at the time it was made.

C. This Statement of Policy shall not be construed as waiving, limiting, or otherwise affecting the power of the FDIC as conservator or receiver to disaffirm or repudiate any agreement or contract that imposes continuing obligations and duties upon the insured depository institution in conservatorship or receivership, which the conservator or receiver, in its discretion, determines would be burdensome and the disaffirmance or repudiation of which will promote the orderly administration of the institution's affairs. As stated above, however, should the FDIC, in order to terminate such continuing obligations or duties, seek to disaffirm or repudiate an agreement or contract under which an insured depository institution has transferred financial assets in connection with a securitization or undivided interests in a loan in the form of a loan participation, the FDIC will not

attempt to reclaim, recover, or recharacterize as property of the institution or the receivership estate such financial assets or undivided interests.

D. Nothing in this Statement of Policy shall be construed as waiving, limiting, or otherwise affecting:

(1) The power of the FDIC to take any action or to exercise any power not specifically addressed by this Statement of Policy;

(2) The power of the FDIC to take any action or pursue any legal powers, rights, or remedies regarding any transfer that was made with the intent to hinder, delay, or defraud the institution or its creditors, or in contemplation of insolvency, or that is a fraudulent transfer under applicable law: or

(3) Any causes of action, rights, or remedies, at law or in equity, not specifically addressed by this Statement of Policy, that the FDIC may have with respect to any contract entered into by any insured depository institution.

By order of the Board of Directors.

Dated at Washington, D.C., this 18th day of December 1998.

Federal Deposit Insurance Corporation Robert E. Feldman,

Executive Secretary.

[FR Doc. 98-34518 Filed 12-29-98; 8:45 am] BILLING CODE 6714-01-P

FEDERAL MARITIME COMMISSION

Notice of Agreement(s) Filed

The Commission hereby gives notice of the filing of the following agreement(s) under the Shipping Act of 1984. Interested parties can review or obtain copies of agreements at the Washington, DC offices of the Commission, 800 North Capitol Street, N.W., Room 962. Interested parties may submit comments on an agreement to the Secretary, Federal Maritime Commission, Washington, DC 20573, within 10 days of the date this notice appears in the Federal Register.

Agreement No.: 232-011644.
Title: Sol y Mar/Frontier Services
Space Charter and Sailing Agreement.
Parties: Sol y Mar, Frontier Liner
Services

Synopsis: Under the proposed agreement, Sol y Mar will charter space to Frontier Liner Services in the trade between ports in south Florida and ports in Guatemala and Honduras and via those ports to Nicaragua and El Salvador.

Agreement No.: 232–011645. Title: Ro/Ro Vessel Chartering Agreement. Parties: Companhia de Navegacao Norsul, NYKNOS Joint Service.

Synopsis: Under the proposed agreement, the parties are authorized to charter ro/ro vessels to each other, cross charter space, and coordinate sailings and port calls in the trade between U.S. Atlantic and Gulf ports and inland points and ports and points in Brazil, Argentina, Paraguay, and Uruguay.

By Order of the Federal Maritime Commission.

Dated: December 23, 1998.

Joseph C. Polking,

Secretary.

[FR Doc. 98-34512 Filed 12-29-98; 8:45 am] BILLING CODE 6730-01-M

FEDERAL MARITIME COMMISSION

Meetings; Sunshine Act

AGENCY HOLDING THE MEETING: Federal Maritime Commission.

TIME AND DATE: 2:00 P.M.—January 13, 1999.

PLACE: 800 North Capitol Street, N.W., First Floor Hearing Room, Washington, D.C.

STATUS: CLOSED.

MATTER(S) TO BE CONSIDERED:

Docket No. 98-14—Shipping
 Restrictions, Requirements and
 Practices of the People's Republic of
 China.

Brazilian Maritime Policies Affecting
 U.S.-Brazil Trades.

CONTACT PERSON FOR MORE INFORMATION: Joseph C. Polking, Secretary, (202) 523–5725.

Joseph C. Polking,

Secretary

[FR Doc. 98–34670 Filed 12-28-98; 11:11 am] BILLING CODE 6730–01–M

FEDERAL RESERVE SYSTEM

Agency Information Collection Activities: Announcement of Board Approval under Delegated Authority and Submission to OMB

AGENCY: Board of Governors of the Federal Reserve System SUMMARY: Background. Notice is hereby given of the final approval of proposed information collection by the Board of Governors of the Federal Reserve System (Board) under OMB delegated authority, as per 5 CFR 1320.16 (OMB Regulations on Controlling Paperwork Burdens on the Public). Board-approved collections of information are incorporated into the official OMB inventory of currently approved

collections of information. Copies of the OMB 83-Is and supporting statements and approved collection of information instrument(s) are placed into OMB's public docket files. The Federal Reserve may not conduct or sponsor, and the respondent is not required to respond to, an information collection that has been extended, revised, or implemented on or after October 1, 1995, unless it displays a currently valid OMB control number.

FOR FURTHER INFORMATION CONTACT:

Chief, Financial Reports Section—Mary M. McLaughlin—Division of Research and Statistics, Board of Governors of the Federal Reserve System, Washington, DC 20551 (202-452-3829).

OMB Desk Officer—Alexander T. Hunt—Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Room 3208, Washington, DC 20503 (202-395-7860).

Final approval under OMB delegated authority of the extension for three years, with major revision, of the following report:

Report title: Interagency Bank Merger Act Application.

Agency form number: FR 2070 OMB control number: 7100-0171 Frequency: On occasion Reporters: Individuals or households:

Businesses or other for-profit.

Annual reporting hours:

Nonaffiliate—1,710; Affiliate—1,422. Total: 3,132 burden hours Estimated average hours per response: Nonaffiliate--30; Affiliate--18

Number of respondents: Nonaffiliate--57; Affiliate--79.

Small businesses are affected.

General description of report: This information collection is mandatory (12 U.S.C. 321, 1828(c), and 4804). Except for select sensitive items, this information collection is not given confidential treatment.

Abstract: State member banks are required to file this application prior to merging with any other insured depository institution, consolidating with an insured depository institution, acquiring assets from an insured depository institution (either directly or indirectly), or assuming the liability to pay any of an insured depository institution's deposits (either directly or indirectly).

This extension proposal includes a revision to make uniform the merger application forms currently submitted to the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), the Federal Deposit Insurance Corporation (FDIC), and the Board of Governors (Board)

Allotments, Television Broadcast Stations (Riverside, California) (MB Docket No. 08-30).

Number of Petitions Filed: 1. Subject: In the Matter of Improving Public Safety Communications in the 800 MHz Band (WT Docket No. 02-55). New 800 MHz Band Plan for U.S.-Canada Border Region.

Number of Petitions Filed: 1.

Marlene H. Dortch,

Secretary.

[FR Doc. E8-17276 Filed 7-25-08; 8:45 am] BILLING CODE 6712-01-P

FEDERAL DEPOSIT INSURANCE CORPORATION

Covered Bond Policy Statement

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final Statement of Policy.

SUMMARY: The Federal Deposit Insurance Corporation (the FDIC) is publishing a final policy statement on the treatment of covered bonds in a conservatorship or receivership. This policy statement provides guidance on the availability of expedited access to collateral pledged for certain covered bonds after the FDIC decides whether to terminate or continue the transaction. Specifically, the policy statement clarifies how the FDIC will apply the consent requirements of section 11(e)(13)(C) of the Federal Deposit Insurance Act (FDIA) to such covered bonds to facilitate the prudent development of the U.S. covered bond market consistent with the FDIC's responsibilities as conservator or receiver for insured depository institutions (IDI). As the U.S. covered bond market develops, future modifications or amendments may be considered by the FDIC.

DATES: Effective Date: July 28, 2008. FOR FURTHER INFORMATION CONTACT: Richard T. Aboussie, Associate General Counsel, Legal Division, (703) 562-2452; Michael H. Krimminger, Special Advisor for Policy, (202) 898-8950.

SUPPLEMENTARY INFORMATION:

I. Background

On April 23, 2008, the FDIC published the Interim Final Covered Bond Policy Statement for public comment. 73 FR 21949 (April 23, 2008). After carefully reviewing and considering all comments, the FDIC has adopted certain limited revisions and clarifications to the Interim Policy

Statement (as discussed in Part II) in the Final Policy Statement.1

Currently, there are no statutory or regulatory prohibitions on the issuance of covered bonds by U.S. banks. Therefore, to reduce market uncertainty and clarify the application of the FDIC's statutory authorities for U.S. covered bond transactions, the FDIC issued an Interim Policy Statement to provide guidance on the availability of expedited access to collateral pledged for certain covered bonds by IDIs in a conservatorship or a receivership. As discussed below, under section 11(e)(13)(C) of the FDIA, any liquidation of collateral of an IDI placed into conservatorship or receivership requires the consent of the FDIC during the initial 45 days or 90 days after its appointment, respectively. Consequently, issuers of covered bonds have incurred additional costs from maintaining additional liquidity needed to insure continued payment on outstanding bonds if the FDIC as conservator or receiver fails to make payment or provide access to the pledged collateral during these periods after any decision by the FDIC to terminate the covered bond transaction. The Policy Statement does not impose any new obligations on the FDIC, as conservator or receiver, but does define the circumstances and the specific covered bond transactions for which the FDIC will grant consent to expedited access to pledged covered bond collateral.

Covered bonds are general, nondeposit obligation bonds of the issuing bank secured by a pledge of loans that remain on the bank's balance sheet. Covered bonds originated in Europe, where they are subject to extensive statutory and supervisory regulation designed to protect the interests of covered bond investors from the risks of insolvency of the issuing bank. By contrast, covered bonds are a relatively new innovation in the U.S. with only two issuers to date: Bank of America, N.A. and Washington Mutual. These initial U.S. covered bonds were issued in September 2006.

In the covered bond transactions initiated in the U.S. to date, an IDI sells mortgage bonds, secured by mortgages, to a trust or similar entity ("special purpose vehicle" or "SPV").2 The

pledged mortgages remain on the IDI's balance sheet, securing the IDI's obligation to make payments on the debt, and the SPV sells covered bonds, secured by the mortgage bonds, to investors. In the event of a default by the IDI, the mortgage bond trustee takes possession of the pledged mortgages and continues to make payments to the SPV to service the covered bonds. Proponents argue that covered bonds provide new and additional sources of liquidity and diversity to an

institution's funding base.

The FDIC agrees that covered bonds may be a useful liquidity tool for IDIs as part of an overall prudent liquidity management framework and within the parameters set forth in the Policy Statement. While covered bonds, like other secured liabilities, could increase the costs to the deposit insurance fund in a receivership, these potential costs must be balanced with diversification of sources of liquidity and the benefits that accrue from additional on-balance sheet alternatives to securitization for financing mortgage lending. The Policy Statement seeks to balance these considerations by clarifying the conditions and circumstances under which the FDIC will grant automatic consent to access pledged covered bond collateral. The FDIC believes that the prudential limitations set forth in the Policy Statement permit the incremental development of the covered bond market, while allowing the FDIC, and other regulators, the opportunity to evaluate these transactions within the U.S. mortgage market. In fulfillment of its responsibilities as deposit insurer and receiver for failed IDIs, the FDIC will continue to review the development of the covered bond marketplace in the U.S. and abroad to gain further insight into the appropriate role of covered bonds in IDI funding and the U.S. mortgage market, and their potential consequences for the deposit insurance fund. (For ease of reference. throughout this discussion, when we refer to "covered bond obligation," we are referring to the part of the covered bond transaction comprising the IDI's debt obligation, whether to the SPV, mortgage bond trustee, or other parties; and "covered bond obligee" is the entity to which the IDI is indebted.)

Under the FDIA, when the FDIC is appointed conservator or receiver of an IDI, contracting parties cannot terminate agreements with the IDI because of the insolvency itself or the appointment of

¹ For ease of reference, the Interim Final Covered Bond Policy Statement, published on April 23, 2008, will be referred to as the Interim Policy Statement The Final Covered Bond Policy Statement will be referred to as the Policy

² The FDIC understands that certain potential issuers may propose a different structure that does not involve the use of an SPV. The FDIC expresses

no opinion about the appropriateness of SPV or socalled "direct issuance" covered bond structures, although both may comply with this Statement of

the conservator or receiver. In addition, contracting parties must obtain the FDIC's consent during the forty-five day period after appointment of FDIC as conservator, or during the ninety day period after appointment of FDIC as receiver before, among other things, terminating any contract or liquidating any collateral pledged for a secured transaction.3 During this period, the FDIC must still comply with otherwise enforceable provisions of the contract. The FDIC also may terminate or repudiate any contract of the IDI within a reasonable time after the FDIC's appointment as conservator or receiver if the conservator or receiver determines that the agreement is burdensome and that the repudiation will promote the orderly administration of the IDI's

As conservator or receiver for an IDI, the FDIC has three options in responding to a properly structured covered bond transaction of the IDI: (1) Continue to perform on the covered bond transaction under its terms; (2) pay off the covered bonds in cash up to the value of the pledged collateral; or (3) allow liquidation of the pledged collateral to pay off the covered bonds. If the FDIC adopts the first option, it would continue to make the covered bond payments as scheduled. The second or third options would be triggered if the FDIC repudiated the transaction or if a monetary default occurred. In both cases, the par value of the covered bonds plus interest accrued to the date of the appointment of the FDIC as conservator or receiver would be paid in full up to the value of the collateral. If the value of the pledged collateral exceeded the total amount of all valid claims held by the secured parties, this excess value or over collateralization would be returned to the FDIC, as conservator or receiver, for distribution as mandated by the FDIA. On the other hand, if there were insufficient collateral pledged to cover all valid claims by the secured parties, the amount of the claims in excess of the pledged collateral would be unsecured claims in the receivership.

While the FDIC can repudiate the underlying contract, and thereby terminate any continuing obligations under that contract, the FDIA prohibits the FDIC, as conservator or receiver from avoiding any legally enforceable or perfected security interest in the assets of the IDI unless the interest was taken

in contemplation of the IDI's insolvency or with the intent to hinder, delay, or defraud the IDI or its creditors. This statutory provision ensures protection for the valid claims of secured creditors up to the value of the pledged collateral. After a default or repudiation, the FDIC as conservator or receiver may either pay resulting damages in cash up to the value of the collateral or turn over the collateral to the secured party for liquidation. For example, if the conservator or receiver repudiated a covered bond transaction, as discussed in Part II below, it would pay damages limited to par value of the covered bonds and accrued interest up to the date of appointment of the conservator or receiver, if sufficient collateral was in the cover pool, or turn over the collateral for liquidation with the conservator or receiver recovering any proceeds in excess of those damages. In liquidating any collateral for a covered bond transaction, it would be essential that the secured party liquidate the collateral in a commercially reasonable and expeditious manner taking into account the then-existing market conditions.

As noted above, existing covered bond transactions by U.S. issuers have used SPVs. However, nothing in the Policy Statement requires the use of an SPV. Some questions have been posed about the treatment of a subsidiary or SPV after appointment of the FDIC as conservator or receiver. The FDIC applies well-defined standards to determine whether to treat such entities as "separate" from the IDI. If a subsidiary or SPV, in fact, has fulfilled all requirements for treatment as a "separate" entity under applicable law, the FDIC as conservator or receiver has not applied its statutory powers to the subsidiary's or SPV's contracts with third parties. While the determination of whether a subsidiary or SPV has been organized and maintained as a separate entity from the IDI must be determined based on the specific facts and circumstances, the standards for such decisions are set forth in generally applicable judicial decisions and in the FDIC's regulation governing subsidiaries of insured state banks, 12 CFR 362.4.

The requests to the FDIC for guidance have focused principally on the conditions under which the FDIC would grant consent to obtain collateral for a covered bond transaction before the expiration of the forty-five day period after appointment of a conservator or the ninety day period after appointment of a receiver. IDIs interested in issuing covered bonds have expressed concern

that the requirement to seek the FDIC's consent before exercising on the collateral after a breach could interrupt payments to the covered bond obligee for as long as 90 days. IDIs can provide for additional liquidity or other hedges to accommodate this potential risk to the continuity of covered bond payments but at an additional cost to the transaction. Interested parties requested that the FDIC provide clarification about how FDIC would apply the consent requirement with respect to covered bonds. Accordingly, the FDIC has determined to issue this Final Covered Bond Policy Statement in order to provide covered bond issuers with final guidance on how the FDIC will treat covered bonds in a conservatorship or receivership.

II. Overview of the Comments

The FDIC received approximately 130 comment letters on the Interim Policy Statement; these included comments from national banks, Federal Home Loan Banks, industry groups and individuals.

Most commenters encouraged the FDIC to adopt the Policy Statement to clarify how the FDIC would treat covered bonds in the case of a conservatorship or receivership and, thereby, facilitate the development of the U.S. covered bond market. The more detailed comments focused on one or more of the following categories of issues: (1) The FDIC's discretion regarding covered bonds that do not comply with the Policy Statement; (2) application to covered bonds completed prior to the Policy Statement; (3) the limitation of the Policy Statement to covered bonds not exceeding 4 percent of liabilities; (4) the eligible collateral for the cover pools; (5) the measure of damages provided in the event of default or repudiation; (6) the covered bond term limit; and (7) federal home loan bank advances and assessments.

Certain banks and industry associations sought clarification about the treatment of covered bonds that do not comply with the Policy Statement by the FDIC as conservator or receiver. Specifically, commenters asked the FDIC to clarify that if a covered bond issuance is not in conformance with the Policy Statement, the FDIC retains discretion to grant consent prior to expiration of the 45 or 90 day period on a case-by-case basis. Under Section 11(e)(13)(C) of the FDIA, the exercise of any right or power to terminate, accelerate, declare a default, or otherwise affect any contract of the IDI, or to take possession of any property of the IDI, requires the consent of the conservator or receiver, as appropriate,

³ See 12 U.S.C. 1821(e)(13)(C).

^{*}See 12 U.S.C. 1821(e)(3) and (13). These provisions do not apply in the manner stated to "qualified financial contracts" as defined in Section 11(e) of the FDI Act. See 12 U.S.C. 1821(e)(8).

⁵ See 12 U.S.C. 1821(e)(12).

during the 45-day period or 90-day period after the date of the appointment of the conservator or receiver, as applicable. By the statutory terms, the conservator or receiver retains the discretion to give consent on a case-by-case basis after evaluation by the FDIC upon the failure of the issuer.

Comments from banks who issued covered bonds prior to the Policy Statement requested either 'grandfathering' of preexisting covered bonds or an advance determination by the FDIC before any appointment of a conservator or receiver that specific preexisting covered bonds qualified under the Policy Statement. After carefully considering the comments, the FDIC has determined that to 'grandfather' or otherwise permit mortgages or other collateral that do not meet the specific requirements of the Policy Statement to support covered bonds would not promote stable and resilient covered bonds as encompassed within the Policy Statement. If preexisting covered bonds, and their collateral, otherwise qualify under the standards specified in the Policy Statement, those covered bonds would be eligible for the expedited access to collateral provided by the Policy

A number of commenters requested that the limitation of eligible covered bonds to no more than 4 percent of an IDI's total liabilities should be removed or increased. Commenters also noted that other countries applying a cap have based the limitation on assets, not liabilities. The Policy Statement applies to covered bond issuances that comprise no more than 4 percent of an institution's total liabilities since, in part, as the proportion of secured liabilities increases, the total unpledged assets available to satisfy the claims of uninsured depositors and other creditors from the Deposit Insurance Fund decrease. As a result, the FDIC must focus on the share of an IDI's liabilities that are secured by collateral and balance the additional potential losses in the failure of an IDI against the benefits of increased liquidity for open institutions. The 4 percent limitation under the Policy Statement is designed to permit the FDIC, and other regulators, an opportunity to evaluate the development of the covered bond market within the financial system of the United States, which differs in many respects from that in other countries deploying covered bonds. Consequently, while changes may be considered to this limitation as the covered bond market develops, the FDIC has decided not to make any change at this time.

A number of commenters sought expansion of the mortgages defined as "eligible mortgages" and the expansion of collateral for cover pools to include other assets, such as second-lien home equity loans and home equity lines of credit, credit card receivables, mortgages on commercial properties, public sector debt, and student loans. Other commenters requested that "eligible mortgages" should be defined solely by their loan-to-value (LTV) ratios. After considering these comments, the FDIC has determined that its interests in efficient resolution of IDIs, as well as in the initial development of a resilient covered bond market that can provide reliable liquidity for well-underwritten mortgages, support retention of the limitations on collateral for qualifying covered bonds in the Interim Policy Statement. Recent market experience demonstrates that many mortgages that would not qualify under the Policy Statement, such as low documentation mortgages, have declined sharply in value as credit conditions have deteriorated. Some of the other assets proposed are subject to substantial volatility as well, while others would not specifically support additional liquidity for well-underwritten residential mortgages. As noted above, certain provisions of the Policy Statement may be reviewed and reconsidered as the U.S. covered bond market develops.

With regard to the comments that LTV be used as a guide to determine an "eligible mortgage," the FDIC does not believe that LTV can substitute for strong underwriting criteria to ensure sustainable mortgages. In response to the comments, and the important role that LTV plays in mortgage analysis, the Policy Statement will urge issuers to disclose LTV for mortgages in the cover pool to enhance transparency for the covered bond market and promote stable cover pools. However, no specific LTV limitation will be imposed.

Two commenters suggested that the Policy Statement should be clarified to permit the substitution of cash as cover pool collateral. The Policy Statement has been modified to allow for the substitution of cash and Treasury and agency securities. The substitution of such collateral does not impair the strength of the cover pool and may be an important tool to limit short-term strains on issuing IDIs if eligible mortgages or AAA-rated mortgage securities must be withdrawn from the cover pool.

A number of commenters requested guidance on the calculation of damages the receiver will pay to holders of

covered bonds in the case of repudiation or default. Under 12 U.S.C. 1821(e)(3), the liability of the conservator or receiver for the disaffirmance or repudiation of any contract is limited to "actual direct compensatory damages" and determined as of the date of appointment of the conservator or receiver. In the repudiation of contracts, such damages generally are defined by the amount due under the contract repudiated, but excluding any amounts for lost profits or opportunities, other indirect or contingent claims, pain and suffering, and exemplary or punitive damages. Under the Policy Statement, the FDIC agrees that "actual direct compensatory damages" due to bondholders, or their representative(s) for repudiation of covered bonds will be limited to the par value of the bonds plus accrued interest as of the date of appointment of the FDIC as conservator or receiver. The FDIC anticipates that IDIs issuing covered bonds, like other obligations bearing interest rate or other risks, will undertake prudent hedging strategies for such risks as part of their risk management program.

Many commenters suggested that the 10-year term limit should be removed to permit longer-term covered bond maturities. After reviewing the comments, the FDIC agrees that longer-term covered bonds should not pose a significant, additional risk and may avoid short-term funding volatility. Therefore, the FDIC has revised the Interim Policy Statement by increasing the term limit for covered bonds from 10 years to 30 years.

A number of the Federal Home Loan Banks, and their member institutions, objected to the inclusion of FHLB advances in the definition of "secured liabilities," any imposed cap on such advances, and any change in assessment rates. Under 12 CFR part 360.2 (Federal Home Loan Banks as Secured Creditors), secured liabilities include loans from the Federal Reserve Bank discount window, Federal Home Loan Bank (FHLB) advances, repurchase agreements, and public deposits. However, the Policy Statement does not impose a cap on FHLB advances and has no effect on an IDI's ability to obtain FHLB advances or its deposit insurance assessments. The Policy Statement solely addresses covered bonds.

However, as noted above, where an IDI relies very heavily on secured liabilities to finance its lending and other business activities, it does pose a greater risk of loss to the Deposit Insurance Fund in any failure. Should the covered bond market develop as a significant source of funding for IDIs, and should that development create

substantial increases in an IDI's reliance on secured funding, it would increase the FDIC's losses in a failure and perhaps outweigh the benefits of improved liquidity. As a result, it is appropriate for the FDIC to consider the risks of such increased losses. Consideration of these risks may occur in a possible future request for comments on secured liabilities, but they are not addressed in this Policy Statement.

III. Final Statement of Policy

For the purposes of this final Policy Statement, a "covered bond" is defined as a non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by a pool of eligible mortgages or, not exceeding ten percent of the collateral, by AAA-rated mortgage bonds. The term "covered bond obligee" is the entity to which the IDI is indebted.

To provide guidance to potential covered bond issuers and investors, while allowing the FDIC to evaluate the potential benefits and risks that covered bond transactions may pose to the deposit insurance fund in the U.S. mortgage market, the application of the policy statement is limited to covered bonds that meet the following

This Policy Statement only applies to covered bond issuances made with the consent of the IDI's primary federal regulator in which the IDI's total covered bond obligations at such issuance comprise no more than 4 percent of an IDI's total liabilities. The FDIC is concerned that unrestricted growth while the FDIC is evaluating the potential benefits and risks of covered bonds could excessively increase the proportion of secured liabilities to unsecured liabilities. The larger the balance of secured liabilities on the balance sheet, the smaller the value of assets that are available to satisfy depositors and general creditors, and consequently the greater the potential loss to the Deposit Insurance Fund. To address these concerns, the policy statement is limited to covered bonds that comprise no more than 4 percent of a financial institution's total liabilities after issuance.

In order to limit the risks to the deposit insurance fund, application of the Policy Statement is restricted to covered bond issuances secured by perfected security interests under applicable state and federal law on performing eligible mortgages on one-to-four family residential properties, underwritten at the fully indexed rate

and relying on documented income, a limited volume of AAA-rated mortgage securities, and certain substitution collateral. The Policy Statement provides that the mortgages shall be underwritten at the fully indexed rate relying on documented income, and comply with existing supervisory guidance governing the underwriting of residential mortgages, including the Interagency Guidance on Non-Traditional Mortgage Products, October 5, 2006, and the Interagency Statement on Subprime Mortgage Lending, July 10, 2007, and such additional guidance applicable at the time of loan origination. In addition, the Policy Statement requires that the eligible mortgages and other collateral pledged for the covered bonds be held and owned by the IDI. This requirement is designed to protect the FDIC's interests in any over collateralization and avoid structures involving the transfer of the collateral to a subsidiary or SPV at initiation or prior to any IDI default under the covered bond transaction.

The FDIC recognizes that some covered bond programs include mortgage-backed securities in limited quantities. Staff believes that allowing some limited inclusion of AAA-rated mortgage-backed securities as collateral for covered bonds during this interim, evaluation period will support enhanced liquidity for mortgage finance without increasing the risks to the deposit insurance fund. Therefore, covered bonds that include up to 10 percent of their collateral in AAA-rated mortgage securities backed solely by mortgage loans that are made in compliance with guidance referenced above will meet the standards set forth in the Policy Statement. In addition, substitution collateral for the covered bonds may include cash and Treasury and agency securities as necessary to prudently manage the cover pool. Securities backed by tranches in other securities or assets (such as Collateralized Debt Obligations) are not considered to be acceptable collateral.

The Policy Statement provides that the consent of the FDIC, as conservator or receiver, is provided to covered bond obligees to exercise their contractual rights over collateral for covered bond transactions conforming to the Interim Policy Statement no sooner than ten (10) business days after a monetary default on an IDI's obligation to the covered bond obligee, as defined below, or ten (10) business days after the effective date of repudiation as provided in written notice by the conservator or

The FDIC anticipates that future developments in the marketplace may

present interim final covered bond structures and structural elements that are not encompassed within this Policy Statement and therefore the FDIC may consider future amendment (with appropriate notice) of this Policy Statement as the U.S. covered bond market develops.

IV. Scope and Applicability

This Policy Statement applies to the FDIC in its capacity as conservator or receiver of an insured depository institution.

This Policy Statement only addresses the rights of the FDIC under 12 U.S.C. 1821(e)(13)(C). A previous policy statement entitled "Statement of Policy on Foreclosure Consent and Redemption Rights," August 17, 1992, separately addresses consent under 12 U.S.C. 1825(b), and should be separately consulted.

This Policy Statement does not authorize, and shall not be construed as authorizing, the waiver of the prohibitions in 12 U.S.C. 1825(b)(2) against levy, attachment, garnishment, foreclosure or sale of property of the FDIC, nor does it authorize or shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC. The Policy Statement provides that it shall not be construed as waiving, limiting or otherwise affecting the rights or powers of the FDIC to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers or remedies of the FDIC regarding transfers taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution, or that is a fraudulent transfer under applicable

The Board of Directors of the FDIC has adopted a final Covered Bond Policy Statement. The text of the Covered Bond Policy Statement follows:

Covered Bond Policy Statement

Background

Insured depository institutions ("IDIs") are showing increasing interest in issuing covered bonds. Although covered bond structures vary, in all covered bonds the IDI issues a debt obligation secured by a pledge of assets, typically mortgages. The debt obligation is either a covered bond sold directly to investors, or mortgage bonds which are sold to a trust or similar entity ("special purpose vehicle" or "SPV") as collateral for the SPV to sell covered bonds to investors. In either case, the IDI's debt obligation is secured by a perfected first

priority security interest in pledged mortgages, which remain on the IDI's balance sheet. Proponents argue that covered bonds provide new and additional sources of liquidity and diversity to an institution's funding base. Based upon the information available to date, the FDIC agrees that covered bonds may be a useful liquidity tool for IDIs as part of an overall prudent liquidity management framework and the parameters set forth in this policy statement. Because of the increasing interest IDIs have in issuing covered bonds, the FDIC has determined to issue this policy statement with respect to covered bonds.

(a) Definitions.

(1) For the purposes of this policy statement, a "covered bond" shall be defined as a non-deposit, recourse debt obligation of an IDI with a term greater than one year and no more than thirty years, that is secured directly or indirectly by perfected security interests under applicable state and federal law on assets held and owned by the IDI consisting of eligible mortgages, or AAA-rated mortgage-backed securities secured by eligible mortgages if for no more than ten percent of the collateral for any covered bond issuance or series. Such covered bonds may permit substitution of cash and United States Treasury and agency securities for the initial collateral as necessary to prudently manage the cover pool.

(2) The term "eligible mortgages" shall mean performing first-lien mortgages on one-to-four family residential properties, underwritten at the fully indexed rate 6 and relying on documented income, and complying with existing supervisory guidance governing the underwriting of residential mortgages, including the Interagency Guidance on Non-Traditional Mortgage Products, October 5, 2006, and the Interagency Statement on Subprime Mortgage Lending, July 10, 2007, and such additional guidance applicable at the time of loan origination. Due to the predictive quality of loan-to-value ratios in evaluating residential mortgages, issuers should disclose loan-to-value ratios for the cover pool to enhance transparency for the covered bond market.

(3) The term "covered bond obligation," shall be defined as the portion of the covered bond transaction that is the insured depository institution's debt obligation, whether to the SPV, mortgage bond trustee, or other

(4) The term "covered bond obligee" is the entity to which the insured depository institution is indebted.

(5) The term ''monetary default'' shall mean the failure to pay when due (taking into account any period for cure of such failure or for forbearance provided under the instrument or in law) sums of money that are owed, without dispute, to the covered bond obligee under the terms of any bona fide instrument creating the obligation to

pay.
(6) The term "total liabilities" shall mean, for banks that file quarterly Reports of Condition and Income (Call Reports), line 21 "Total liabilities" (Schedule RC); and for thrifts that file quarterly Thrift Financial Reports (TFRs), line SC70 "Total liabilities"

(Schedule SC).

(b) Coverage. This policy statement only applies to covered bond issuances made with the consent of the IDI's primary federal regulator in which the IDI's total covered bond obligation as a result of such issuance comprises no more than 4 percent of an IDI's total liabilities, and only so long as the assets securing the covered bond obligation are eligible mortgages or AAA-rated mortgage securities on eligible mortgages, if not exceeding 10 percent of the collateral for any covered bond issuance, Substitution for the initial cover pool collateral may include cash and Treasury and agency securities as necessary to prudently manage the cover pool.
(c) Consent to certain actions. The

FDIC as conservator or receiver consents to a covered bond obligee's exercise of the rights and powers listed in 12 U.S.C. 1821(e)(13)(C), and will not assert any rights to which it may be entitled pursuant to 12 U.S.C. 1821(e)(13)(C), after the expiration of the specified amount of time, and the occurrence of

the following events:

(1) If at any time after appointment the conservator or receiver is in a monetary default to a covered bond obligee, as defined above, and remains in monetary default for ten (10) business days after actual delivery of a written request to the FDIC pursuant to paragraph (d) hereof to exercise contractual rights because of such monetary default, the FDIC hereby consents pursuant to 12 U.S.C. 1821(e)(13)(C) to the covered bond obligee's exercise of any such

contractual rights, including liquidation of properly pledged collateral by commercially reasonable and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.

(2) If the FDIC as conservator or receiver of an insured depository institution provides a written notice of repudiation of a contract to a covered bond obligee, and the FDIC does not pay the damages due pursuant to 12 U.S.C. 1821(e) by reason of such repudiation within ten (10) business days after the effective date of the notice, the FDIC hereby consents pursuant to 12 U.S.C. 1821(e)(13)(C) for the covered bond obligee's exercise of any of its contractual rights, including liquidation of properly pledged collateral by commercially reasonable and expeditious methods taking into account existing market conditions, provided no involvement of the receiver or conservator is required.
(3) The liability of a conservator or

receiver for the disaffirmance or repudiation of any covered bond issuance obligation, or for any monetary default on, any covered bond issuance, shall be limited to the par value of the bonds issued, plus contract interest accrued thereon to the date of appointment of the conservator or

receiver.

(d) Consent. Any party requesting the FDIC's consent as conservator or receiver pursuant to 12 U.S.C. 1821(e)(13)(C) pursuant to this policy statement should provide to the Deputy Director, Division of Resolutions and Receiverships, Federal Deposit Insurance Corporation, 550 17th Street, NW., F-7076, Washington DC 20429-0002, a statement of the basis upon which such request is made, and copies of all documentation supporting such request, including without limitation a copy of the applicable contract and of any applicable notices under the contract.

(e) Limitations. The consents set forth in this policy statement do not act to waive or relinquish any rights granted to the FDIC in any capacity, pursuant to any other applicable law or any agreement or contract. Nothing contained in this policy alters the claims priority of collateralized obligations. Nothing contained in this policy statement shall be construed as permitting the avoidance of any legally enforceable or perfected security interest in any of the assets of an insured depository institution, provided such interest is not taken in contemplation of the institution's insolvency, or with the intent to hinder,

⁶ The fully indexed rate equals the index rate prevailing at origination plus the margin to be added to it after the expiration of an introductor interest rate. For example, assume that a loan with an initial fixed rate of 7% will reset to the sixmonth London Interbank Offered Rate (LIBOR) plus a margin of 6%. If the six-month LIBOR rate equals 5.5%, lenders should qualify the borrower at 11.5% (5.5% + 6%), regardless of any interest rate caps that limit how quickly the fully indexed rate may be reached.

delay or defraud the IDI or its creditors. Subject to the provisions of 12 U.S.C. 1821(e)(13)(C), nothing contained in this policy statement shall be construed as permitting the conservator or receiver to fail to comply with otherwise enforceable provisions of a contract or preventing a covered bond obligee's exercise of any of its contractual rights, including liquidation of properly pledged collateral by commercially

reasonable methods.

(f) No waiver. This policy statement does not authorize, and shall not be construed as authorizing the waiver of the prohibitions in 12 U.S.C. 1825(b)(2) against levy, attachment, garnishment, foreclosure, or sale of property of the FDIC, nor does it authorize nor shall it be construed as authorizing the attachment of any involuntary lien upon the property of the FDIC. Nor shall this policy statement be construed as waiving, limiting or otherwise affecting the rights or powers of the FDIC to take any action or to exercise any power not specifically mentioned, including but not limited to any rights, powers or remedies of the FDIC regarding transfers taken in contemplation of the institution's insolvency or with the intent to hinder, delay or defraud the institution or the creditors of such institution, or that is a fraudulent transfer under applicable law.

(g) No assignment. The right to consent under 12 U.S.C. 1821(e)(13)(C) may not be assigned or transferred to any purchaser of property from the FDIC, other than to a conservator or

bridge bank.

(h) Repeal. This policy statement may be repealed by the FDIC upon 30 days notice provided in the Federal Register, but any repeal shall not apply to any covered bond issuance made in accordance with this policy statement before such repeal.

By order of the Board of Directors. Dated at Washington, DC this 22d day of July, 2008.

Federal Deposit Insurance Corporation. Robert E. Feldman,

Executive Secretary.

[FR Doc. E8-17168 Filed 7-25-08; 8:45 am] BILLING CODE 6714-01-P

FEDERAL MARITIME COMMISSION

Agency Information Collection Activities: Submission for OMB Review; Comment Request

AGENCY: Federal Maritime Commission. ACTION: Notice.

SUMMARY: The Federal Maritime Commission (FMC or Commission) is giving public notice that the agency has submitted to OMB for approval the information collections described in this notice. The public is invited to comment on the proposed information collections pursuant to the Paperwork Reduction Act of 1995.

DATES: Written comments must be submitted to OMB at the address below on or before August 27, 2008 to be assured of consideration.

ADDRESSES: Send comments to the Office of Information and Regulatory Affairs, Office of Management and Budget, *Attention*: Desk Officer for FMC, 725 17th Street, NW., Washington, DC 20503,

OIRA_Submission@OMB.EOP.GOV or fax (202) 395–5806.

FOR FURTHER INFORMATION CONTACT: Requests for additional information or copies of the proposed information collections and supporting statements should be directed to Jane Gregory at telephone number 202–523–5800 or jgregory@fmc.gov.

SUPPLEMENTARY INFORMATION: Pursuant to the Paperwork Reduction Act of 1995 (Pub. L. 104-13), the FMC invites the general public and other Federal agencies to comment on proposed information collections. On May 13, 2008, the FMC published a notice and request for comments in the Federal Register (73 FR 27537) regarding the agency's request for continued approval from OMB for information collections as required by the Paperwork Reduction Act of 1995. The FMC received no comments on any of the requests for extensions of OMB clearance. The FMC has submitted the described information collections to OMB for approval.

In response to this notice, comments and suggestions should address one or more of the following points: (1) The necessity and utility of the proposed information collection for the proper performance of the agency's functions; (2) the accuracy of the estimated burden; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) the use of automated collection techniques or other forms of information technology to minimize the information collection burden.

Information Collections Open for Comment

Title: 46 CFR part 540—Application for Certificate of Financial Responsibility/Form FMC-131.

OMB Approval Number: 3072–0012 (Expires September 30, 2008).

Abstract: Sections 2 and 3 of Public Law 89–777 (46 U.S.C. 44105 and 44106) require owners or charterers of passenger vessels with 50 or more passenger berths or stateroom accommodations and embarking passengers at United Stated ports and territories to establish their financial responsibility to meet liability incurred for death or injury to passengers and other persons, and to indemnify passengers in the event of nonperformance of transportation. The Commission's Rules at 46 CFR part 540 implement Public Law 89–777 and specify financial responsibility coverage requirements for such owners and charterers.

Current Actions: There are no changes to this information collection, and it is being submitted for extension purposes only.

Type of Review: Extension.

Needs and Uses: The information will be used by the Commission's staff to ensure that passenger vessel owners and charterers have evidenced financial responsibility to indemnify passengers and others in the event of nonperformance or casualty.

Frequency: This information is collected when applicants apply for a certificate or when existing certificants change any information in their application forms.

Type of Respondents: The types of respondents are owners, charterers and operators of passenger vessels with 50 or more passenger berths that embark passengers from U.S. ports or territories.

Number of Annual Respondents: The Commission estimates an annual respondent universe of 50.

Estimated Time Per Response: The time per response ranges from .5 to 8 person-hours for reporting and recordkeeping requirements contained in the rules, and 8 person-hours for completing Application Form FMC-131.

Total Annual Burden: The Commission estimates the total personhour burden at 1,478 person-hours.

Title: 46 CFR part 565—Controlled Carriers.

OMB Approval Number: 3072-0060 (Expires September 30, 2008).

Abstract: Section 9 of the Shipping Act of 1984 (46 U.S.C. 40701–40706) requires that the FMC monitor the practices of controlled carriers to ensure that they do not maintain rates or charges in their tariffs and service contracts that are below a level that is just and reasonable; nor establish, maintain or enforce unjust or unreasonable classifications, rules or regulations in those tariffs or service contracts which result or are likely to result in the carriage or handling of cargo at rates or charges that are below a just and reasonable level. 46 CFR part



Federal Deposit Insurance Corporation 550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter FIL-73-2008 August 4, 2008

COVERED BONDS

FDIC Policy Statement on Covered Bonds

Summary: The FDIC has issued the attached final policy statement on the treatment of "covered bonds" if the issuing insured depository institution (IDI) is placed into FDIC receivership or conservatorship. The policy statement provides regulatory clarity by granting expedited access to covered bond collateral if the issuing institution fails and is placed into conservatorship or receivership and meets certain criteria. The FDIC guidance is intended to reduce market uncertainty on the treatment of covered bonds in a receivership or conservatorship, while allowing prudent development of the U.S. covered bond market.

Distribution:

FDIC-Insured Institutions

Suggested Routing:

Chief Executive Officer Chief Financial Officer Chief Lending Officer Board of Directors

Attachment:

Covered Bond Policy Statement

Contacts:

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Note:

FDIC financial institution letters (FILs) may be accessed from the FDIC's Web site at

www.fdic.gov/news/news/financial/200 8/index.html

To receive FILs electronically, please visit

http://www.fdic.gov/about/subscriptions/fil.html.

Paper copies of FDIC financial institution letters may be obtained through the FDIC's Public Information Center, 3501 Fairfax Drive, E-1002, Arlington, VA 22226 (1-877-275-3342 or 703-562-2200).

Highlights:

A "covered bond" is defined as a nondeposit, recourse debt obligation of an IDI with a term greater than one year and less than 30 years that is secured, directly or indirectly, by perfected security interests under applicable state and federal law on assets held and owned by the IDI consisting of eligible mortgages or, not exceeding 10 percent of the collateral for any covered bond issuance or series, AAA-rated mortgage-backed securities secured by eligible mortgages.

Generally, the FDIC's consent is required for access or liquidation of pledged collateral for the first 90 days after the FDIC is appointed receiver or the first 45 days after the FDIC is appointed as conservator. The policy statement provides expedited access to collateral for covered bonds if the FDIC remains in monetary default on the covered bond for 10 business days after receiving notice of default, or if the FDIC does not pay statutory damages within 10 business days after the effective date of repudiation.

The policy statement applies only to covered bond issuances that meet the following criteria:

- The covered bond issuances must be made with the consent of the IDI's primary federal regulator.
- The IDI's total covered bonds at issuance comprise no more than four percent of the IDI's total liabilities.
- Covered bond issuances must be secured by perfected security interests under applicable state and federal law on performing eligible mortgages on one- to four-family residential properties, underwritten at the fully indexed rate, relying on documented income, and complying with applicable supervisory guidance governing the underwriting of residential mortgages. Issuances may also be secured by AAA-rated mortgage securities not exceeding 10 percent of the collateral. Substitution collateral may consist of cash and treasury and agency securities.

Under the policy statement, any liability of a conservator or receiver on covered bonds will be limited to the par value of the bonds issued, plus contract interest accrued up to the date of appointment of the conservator or receiver.

Attachment C

CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA FOURTH APPELLATE DISTRICT DIVISION THREE

CYNTHIA D. TALBOTT, as Trustee, etc.,

Plaintiff and Respondent,

v.

WILLIAM HUSTWIT et al.,

Defendants and Appellants.

G037424

(Super. Ct. No. 04CC10967)

OPINION

Appeal from a judgment of the Superior Court of Orange County, Clay M. Smith, Judge. Affirmed.

William A. Hustwit for Defendants and Appellants.

 $\label{eq:Beauchamp} \mbox{Beauchamp \& Associates and Robert Beauchamp for Plaintiff and Respondent.}$

* * *

Defendants William and Janyce Hustwit challenge a judgment entered against them on a guaranty agreement after the lender foreclosed on real property securing a loan made to the Hustwits' trust. The Hustwits contend the trial court erred in refusing to apply Code of Civil Procedure section 580a, which requires an appraisal of the real property security before the court may issue a deficiency judgment. The Hustwits assert that the general policy against excess recovery by creditors following the foreclosure of real property requires applying section 580a to guarantors as well as principal debtors. Alternatively, the Hustwits argue they were not true guarantors because they were closely related to the debtor as settlers and beneficiaries of the trust.

We conclude the trial court did not err. Case law uniformly holds that section 580a does not apply to guarantors. Moreover, the Hustwits structured the trust to separate themselves from the trust's debts. They are therefore not principal obligors to the loan, but true guarantors. Accordingly, we affirm.

I

FACTUAL AND PROCEDURAL BACKGROUND

The Hustwits are guarantors of a loan plaintiff Cynthia D. Talbott, trustee of the Cynthia D. Talbott Separate Property Trust (Talbott), made to Pacific West Investment Trust (Trust). A trust deed against certain Newport Beach real property secured the Trust's loan obligations. The Trust defaulted and Talbott instituted a nonjudicial foreclosure under the power of sale provision in the trust deed. A trustee sale was held in March 2005. Talbott purchased the property with a \$900,000 credit bid, subject to a senior loan. Talbott then sued the Hustwits under their guaranty agreements for the difference between the \$900,000 credit bid and the unpaid balance of the loan, \$1,288,042.36, plus interest. After a bench trial on stipulated facts, the court issued a

All statutory references are to the Code of Civil Procedure, unless other noted.

written statement of decision awarding Talbott \$432,628.40, plus interest. The Hustwits now appeal.

Π

DISCUSSION

A. Section 580a Does Not Apply to Guarantors

California's antideficiency statutes (§§ 580a, 580b, 580d, 726), enacted during the depression, limit or prohibit lenders from obtaining personal judgments against borrowers where the lender's sale of real property security produces proceeds insufficient to cover the amount of the debt. (See Cornelison v. Kornbluth (1975) 15 Cal.3d 590, 600-602.) Section 580a provides in relevant part: "Whenever a money judgment is sought for the balance due upon an obligation for the payment of which a deed of trust or mortgage with power of sale upon real property or any interest therein was given as security, following the exercise of the power of sale in such deed of trust or mortgage, the plaintiff shall set forth in his or her complaint the entire amount of the indebtedness which was secured by the deed of trust or mortgage at the time of sale, the amount for which the real property or interest therein was sold and the fair market value thereof at the date of sale and the date of that sale. . . . Before rendering any judgment the court shall find the fair market value of the real property, or interest therein sold, at the time of the sale. The court may render judgment for not more than the amount by which the entire amount of the indebtedness due at the time of sale exceeded the fair market value of the real property or interest therein sold at the time of sale with interest thereon from the date of the sale "

The Hustwits contend section 580a applied to them, and the trial court erred in failing to consider evidence that the property's fair market value exceeded the total amount owed Talbott. We disagree.

The Hustwits were held liable as guarantors of the Trust's loan obligation to Talbott. A guarantor is one who promises to answer for the debt or perform the obligation of another when the person ultimately liable fails to pay or perform. (Civ. Code, § 2787.) "A contract of guaranty gives rise to a separate and independent obligation from that which binds the principal debtor." (Security-First Nat. Bank v. Chapman (1940) 41 Cal.App.2d 219, 221.) "Since section 580a has to do solely with actions for recovery of deficiency judgments on the principal obligation [it] has no application to an action against a guarantor [citations] . . ." (Mariners Sav. & Loan Assn. v. Neil (1971) 22 Cal.App.3d 232, 234 (Mariners); Bank of America etc. Assn. v. Hunter (1937) 8 Cal.2d 592; Loeb v. Christie (1936) 6 Cal.2d 416; see also Dreyfuss v. Union Bank of California (2000) 24 Cal.4th 400, 407 ["a creditor's resort to any and all security on a debt does not implicate the antideficiency provisions"].)

The Hustwits do not address the case law holding that guarantors cannot claim the protection of section 580a, and concede they were unable to discover any case law to the contrary. Instead, they cite two cases which recognize a general state policy to prevent secured creditors from obtaining excess recoveries. (See *Bank of Hemet v. United States* (9th Cir. 1981) 643 F.2d 661; *Walter E. Heller Western, Inc. v. Bloxham* (1985) 176 Cal.App.3d 266.) Neither of these cases concern guarantors, and the general policy statements contained in them does not persuade us to abandon Supreme Court precedent.² Accordingly, we conclude section 580a has no application to guarantors.

As the concurrence recognizes, the case law supporting liability here has remained unchanged for over 60 years. We can thus safely assume virtually all of the loan guaranties now in existence were made in reliance upon the current state of the law. Although we share our concurring colleague's observations and concerns, we believe any change in the law affecting liability of guarantors for deficiency judgments should originate with the Legislature, which is better able to measure the impact of altering commercial arrangements by into account the views of experts and affected parties.

B. The Hustwits Are True Guarantors

Although case law is uniform in holding section 580a does not apply to guarantors, the question remains whether the Hustwits were true guarantors. Courts have recognized a distinction between true, independent contracts of guaranty and guaranties executed by the primary obligor. (*Mariners, supra,* 22 Cal.App.3d at p. 234.) "It is well established that where a principal obligor purports to take on additional liability as a guarantor, nothing is added to the primary obligation. [Citations.] The correct inquiry set out by the authority is whether the purported debtor is anything other than an instrumentality used by the individuals who guaranteed the debtor's obligation, and whether such instrumentality actually removed the individuals from their status and obligations as debtors." (*Torrey Pines Bank v. Hoffman* (1991) 231 Cal.App.3d 308, 319-320 (*Torrey Pines*); Cadle Co. II v. Harvey (2000) 83 Cal.App.4th 927, 933.)

In *Torrey Pines*, a bank sued a husband and wife on personal guaranties signed in connection with a construction loan the bank made to a revocable living trust in which the defendants were the trustors, trustees, and primary beneficiaries. The court determined the structure of the trust made any distinction between the guarantors and the debtor insignificant, thus barring the bank from recovering on the guaranties.

Specifically, the court noted that under the trust law at the time, trustees were personally liable on contracts entered into on behalf of their trusts. Accordingly, the trust was deemed a "mere instrumentality." (*Torrey Pines, supra*, 231 Cal.App.3d at p. 321.)

The court, however, did not enunciate a blanket rule applying to all living trusts, clarifying: "We emphasize that our holding is necessarily limited to these facts. While it would be possible in a living trust to create a greater degree of separation of interest between settlor, trustee, and beneficiary (e.g., by the use of a separate trustee), this particular trust device did not accomplish enough division between these interests to enable us to say that the purpose of the antideficiency law would be served by enforcing

these personal guaranties as 'true' guaranties, as opposed to 'purported' guaranties." (Id. at p. 323.)

Similarly, *Riddle v. Lushing* (1962) 203 Cal.App.2d 831, 836, involved a situation in which partners had individually guaranteed a partnership note. Because the partners were already jointly and severally liable on the note as general partners, the court held the guaranty did not change the partners' status as principal obligors. (*Ibid.*)

In contrast, *Mariners, supra*, 22 Cal.App.3d 232, involved a situation where the wife took out a loan secured by her separately-owned real property, and the husband signed a personal guaranty. The court recognized that in many ways a husband and wife are partners, but nonetheless held the husband became a true guarantor because he would not have been personally liable for the loan made to the wife absent the guaranty. (*Id.* at p. 235.)

Here, the trust arrangement provided the Hustwits a significantly greater degree of separation than that in *Torrey Pines*. Although the Hustwits are the settlors of the Trust, they are secondary, not primary, beneficiaries. More importantly, the Hustwits are not trustees of the Trust; instead, the Hustwits used a limited liability company as trustee, thus limiting their personal liability for the Trust's obligations. The Hustwits became true guarantors because the Hustwits' trust arrangement "actually removed the[m] from their status and obligations as debtors." (*Torrey Pines, supra,* 231 Cal.App.3d at p. 320.) Accordingly, we conclude the trial court did not err in holding the protections of section 580a inapplicable in the present case.

III

DISPOSITION

The judgment is affirmed. Talbott is entitled to costs on appeal.

ARONSON, J.

I CONCUR:

O'LEARY, J.

I agree with the reasoning and result of the majority opinion, because both are compelled by Supreme Court authority. However, I write separately to voice concerns about the potential danger for the easy circumvention of the protections offered consumers under California's statutory antideficiency legislation by the use of loan guarantees. (See Code Civ., Proc., §§ 580a, 580b, 580d & 726.)¹ The current "subprime mortgage crisis" at a time of generally declining real estate prices illustrates the public importance of the issue.²

Just three years after the 1933 enactment of antideficiency legislation, the California Supreme Court had occasion to confront the issue of deficiency judgments against guarantors in *Loeb v. Christie* (1936) 6 Cal.2d 416 in the specific context of whether a statute (Civ. Code, § 2809) that provides that guarantors do not assume any obligation "more burdensome" than that assumed by the principal debtor, would apply to deficiency judgments. The court reasoned that the answer was no, because the principal still "remains liable at all times for the full amount of the obligation and may be compelled to pay it, first out of the security, *and thereafter out of his general assets*."

¹ As explained by the California Supreme Court in *Cornelison v. Kornbluth* (1975) 15 Cal.3d 590, 600, antideficiency was a Depression-era response to the potential for "double recovery" by lenders. At a time of declining property prices, lenders would be able to purchase the real property securing the debt at a price below normal market value, and then hold the debtor liable "for a large deficiency." Later, the incentive on the part of the lender to bid too low was removed by creating a right of redemption (bid too low and the debtor could get the property back for that amount!) and the right of redemption was extended to both private and judicial foreclosures. The point being: If a lender wanted a deficiency judgment, the lender would be subject to statutory redemption rights. (*Id.* at pp. 601-602.)

² See Posting of Gary Becker to The Becker-Posner Blog, http://www.becker-posner-blog.com/archives/2007/12 (Dec. 23, 2007) ["The vast majority of economists, including me, were surprised by the extent of the subprime mortgage crisis. This needs to be recognized when evaluating the numerous proposals about how to prevent the next housing crisis, and also about how to help those who are in danger of having their homes foreclosed."] (as of June 9, 2008).)

(Loeb, supra, 6 Cal.2d at p. 420, italics added.) That is, the Loeb rationale was explicitly premised on the law as it existed prior to antideficiency legislation, and accordingly the Loeb court relied on a number of pre-1933 cases for the abstract proposition that a loan guarantee was an obligation "separate and independent" from that of "the principal debtor." A guarantee is merely "a source" -- as distinct from the source -- "from which the obligation of the principal or maker is to be repaid." (Ibid., italics added.)

And indeed, the *Loeb* court did not at all mention the recently enacted antideficiency statutes (the guarantee was executed in 1930). The idea that a guarantor might have, in the wake of those statutes, a substantively "more burdensome" obligation than that assumed by the principal debtor was not addressed.

It was not until about a year later, in *Bank of America etc. Assn. v. Hunter* (1937) 8 Cal.2d 592, that the Supreme Court confronted the 1933 antideficiency legislation. The irony is that the court practically backed into the issue of whether antideficiency legislation properly covers guarantors accidentally, and only then as a minor premise taken for granted in addressing *another* issue.

Hunter was a statute of limitations case. The central question was whether a 1933 amendment to the four-year statute of limitations in section 337 of the Code of Civil Procedure, which provided for a three month limitation after a foreclosure sale, could apply to a guarantor. (See Hunter, supra, 8 Cal.2d at p. 597.) The court did not even mention the 1933 antideficiency legislation until relatively late into the opinion (see Hunter, supra, 8 Cal.2d at pp. 597-598). On those pages the court set up this syllogism in order to demonstrate that the four-year statute of limitations did not apply to guarantors: First, the court stated that the antideficiency legislation of 1933 (specifically section 580a of the Code of Civil Procedure) was added in the same session of the Legislature that added the three-month statute of limitations from foreclosures. Then the court, rather casually as if the issue had not been briefed, stated that a "reading" of the 1933 antideficiency legislation "discloses that its provisions have to do solely with actions for recovery of deficiency judgments on the principal obligation after sale under trust deed or mortgage, as distinguished from a guarantor's obligation such as is here involved." (Id.

at p. 598.) The court then quoted a swath of text from section 580a which contained its own three month statute of limitations from foreclosure. (*Ibid.*) The court then noted the necessity of a parallel limitation in the more general Code of Civil Procedure section 337 in order to "assure consistency between the two sections." (*Ibid.*) From that, the court's "opinion" was that the three month limitation in section 377 was "intended to, and does, prescribe the time within which an action for a deficiency judgment must be commenced," and therefore would have "no application to an action of this character based on the independent obligation of a guarantor." (*Ibid.*)

In short, the *Hunter* court went into a statute of limitations case assuming, as a premise taken for granted, that it was already clear that antideficiency legislation did not cover the "independent" obligation of a guarantor. The court came to that conclusion without ever having confronted the issue head on. And I should also point out that the *Hunter* court, unlike the *Loeb* court, did not confront at all the impact of Civil Code section 2809.

The next development was the change of section 2809 to abolish any distinction between guarantors and sureties. (The pre-1939 version of the statute is quoted in *Loeb* (see *Loeb*, *supra*, 6 Cal.2d at p. 419), and used the phrase "obligation of a guarantor" where the statute now uses the phrase "obligation of a surety.")

The decisive moment came in three years later, about a year into World War II, in *Everts v. Matteson* (1942) 21 Cal.2d 437. *Everts*, like the present case, involved an action on a guarantee.

To understand *Everts*, though, one should begin by parsing Civil Code section 2809, and in particular the statute's use of the words "must be neither larger in amount *nor in other respects* more burdensome than that of the principal." (Italics added.) The phrase "nor in other respects" proves that the guarantor's merely being on the hook for the *amount* of the debt is not the end of a court's inquiry: Besides "amount," the guarantor may not be "in other respects" more burdened than the principal debtor. A logical, natural, and plain reading of the text of section 2809 would thus indicate that if the principal debtor is afforded certain protections against having to pay the entire

"amount" of the debt, *not* to afford those same protections to a guarantor would indeed be to impose "more burdensome" obligations on the guarantor. And, as the present case shows, that's only common sense anyway: If a homeowner need not fear the prospect of a deficiency judgment, and if a guarantor of the homeowner's loan undertakes no more "burdensome" obligations than that undertaken by the homeowner, the guarantor should not have to fear a deficiency judgment either.

And for a brief flicker of a moment, the Supreme Court recognized this intuitive and common sense reading of section 2809 in *Everts*. The entire passage containing that flicker is quoted in the margin.³ The key phrase is that "to require the guarantor to pay a larger amount would *seem to violate* the statutory mandate that his obligation must be neither larger in amount nor in other respects more burdensome than that of the principal." (*Everts, supra*, 21 Cal.2d at p. 445, italics added.)

Alas, the passage recalls Churchill's comment about Stanley Baldwin, who would occasionally stumble over the truth, but manage to pick himself up and go on as if nothing had happened. While the *Everts* court had recognized the statutory inconsistency of not giving guarantors the same antideficiency protection otherwise afforded principal debtors, it just could not bring itself to declare the obvious as a matter of law.

And why not? There are two reasons. The textual reason from the *Everts* court itself was that the *Hunter* court had not drawn any "distinction" between cases where creditors first sue the guarantor and cases where -- as in *Everts* -- the property had been sold and there was a deficiency. (However, as we have seen, the *Hunter* court did not

^{3 &}quot;A logical distinction may be made between the cases where the creditor proceeded against the guarantor before subjecting the trust deed security to the payment of the primary obligation and one where, as in the present action, the creditor has sold the security and applied the proceeds in payment of the primary obligation before suing the guarantor. In the latter situation, since the amount for which judgment may be entered against the principal debtor is fixed by section 580a of the Code of Civil Procedure, to require the guarantor to pay a larger amount would seem to violate the statutory mandate that his obligation must be neither larger in amount nor in other respects more burdensome than that of the principal. (Civ. Code, § 2809.)" (Everts, supra, 21 Cal.3d at p. 445.)

confront section 2809 at all.) And the *Everts* court quickly added that the *Hunter* court had "held" that the antideficiency statute "has no application to an action based upon the independent obligation of a guarantor." (*Everts, supra*, 21 Cal.2d at p. 446.) In short, an idea that the *Hunter* court had backed into indirectly as a minor support for a statute of limitations problem had now hardened into black-letter law.

The second reason is that the *Everts* court had no real reason to subject either *Hunter* and *Loeb* to critical analysis and determine whether either case had really confronted the problem of the impact of the 1933 antideficiency legislation on guarantors. There was no need because the guarantor was going to win the case anyway.

It turned out that the guarantor in *Everts* was actually the principal debtor all along, so antideficiency legislation did apply. (See *Everts, supra*, 21 Cal.2d at p. 450.) The *Everts* court had taketh away, but it also gaveth: What *Everts* took from guarantors by way of dicta (it was dicta because, given the ultimate outcome, it wasn't necessary even to address section 2809 at all) the court gave back by a firm holding that when the guarantor is liable as a principal obligor, it *is* entitled to antideficiency protections. Of course, what the court had taken was a great deal more than what it had given: Bona fide guarantors, as distinct from sham alter egos of the debtor, were now clearly excluded from the protections otherwise afforded principals by antideficiency legislation.

And after *Everts*, there was simply no getting that rather off-putting dye out of the garment. In the wake of the decision, the only real defense left to guarantors when they are sued on deficiencies is the proposition that they are, "in reality," the "primary obligor." (See *Mariner's Sav. & Loan Assn. v. Neil* (1971) 22 Cal.App.3d 232, 235.)

The present case, for example, is a species of that doctrine, with the Hustwits desperately trying to fit themselves into the "in reality" category. As the majority opinion correctly decides -- well, correctly under the current state of the case law -- the Hustwits simply outwitted themselves. They have to take the rough with the smooth, and, more specifically, cannot avail themselves of the protections of limited liability corporations and at the same time claim an obligation is really theirs at the same time. Sometimes piercing the veil can actually help you.

Meanwhile, for most of the 20th Century, property values in California remained stable or increased (with the exception of a major deflation in the early 1990's), so the impetus to re-examine the doctrine that the *Loeb*, *Hunter* and *Evert* decisions had together created almost by accident was removed.

That impetus may again be with us and in any event will be present in any period of significant real property deflation. Given such conditions, there is a real danger that, under the effect of current case law, lenders will seize the non-coverage of guarantors as a loophole to circumvent antideficiency protections otherwise afforded homeowners:

Just get the parents or other relatives to guarantee the loan. Since the guarantee obligation has been held "independent" of the loan, the lender can obtain a deficiency judgment under deflationary conditions.

The Legislature, of course, can readily cure this danger (as it can cure any non-Constitutionally created anomaly in the law with the right drafting). Section 2809 could be amended to say -- "and we mean it," i.e., that the protection afforded guarantors against "more burdensome" obligations than undertaken by the debtors whose debts they guarantee really does apply in the context of antideficiency protections.⁴

However, the problem was created by the courts in the first place -- well, okay -- by the Supreme Court in the first place back in the years following the Depression -- so it is judicially solvable as well. I have no doubt that the modern Supreme Court of today would not stumble into major doctrine the way the court of the mid-1930's and early 1940's did in the *Loeb*, *Hunter* and *Everts*. The Supreme Court certainly has the power

⁴ It would be good idea at the same time to make it clear that Civil Code section 2825 ["A surety is not exonerated by the discharge of his principal by operation of law."] does *not* apply to preclude antideficiency otherwise extended. The idea of section 2809, as explained in *Bloom v. Bender* (1957) 48 Cal.2d 793, 802 [a case not otherwise concerned with antideficiency legislation, there the guarantee was for the credit of sportswear manufacturing company] is that the guarantor undertakes the same obligation as the debtor as dictated by the "conditions" at the time of the execution of the guarantee. Well, at the time of the execution of most guarantees backing up a home mortgage, the *condition* undertaken by the principal debtor is the condition of not having to worry about deficiency judgments.

to re-examine the rather tenuous antecedents of the proposition that section 2809 does not apply in antideficiency contexts, particularly given that the *Everts* court seemed to recognize that it *should* and declined to do so only in deference to decisions that really never decided the issue in the first place. Perhaps with the current subprime crisis, the time has come for our high court to complete the thought it first toyed with back in 1942.

SILLS, P. J.

Attachment D



LENDER ALERT

Legal Issues Affecting Financial Institutions

August 2008

CALIFORNIA PROVIDES FORM OF NOTICE REQUIRED BY NEW FORECLOSURE LAW

By: Neil J. Rubenstein, Esq. and Craig C. Chiang, Esq.

In our July 2008 Lender's Alert, we notified you of the enactment of California SB 1137, which added new procedural steps that a lender must follow in California before conducting a non-judicial foreclosure sale under a deed of trust covering the principal residence of any person, when the deed of trust secures a loan made between January 1, 2003 and December 31, 2007.

Section 4 of SB 1137 adds Section 2924.8 to the California Civil Code to require a trustee or authorized agent, at the time it posts a notice of sale, to also post on the property and to mail to the resident of the property, a notice in English with translations in five additional languages, stating that the property may soon be sold at foreclosure and providing certain other information. The English wording to be including in the posting and mailing is identified in the statute. The statute says that a state government entity shall make available translations of the notice.

The State of California Department of Financial Institutions has provided translations of the notice in the required languages, which are Korean, Vietnamese, Chinese, Tagalog, and Spanish. We have attached a copy of the translations, which can also be accessed from the Department of Financial Institutions' website through the following link: http://www.corp.ca.gov/FSD/pdf/Notice_of_Sale.pdf

This new section becomes operative on September 6, 2008, which is 60 days after the effective date of the act.

To read our July 2008 Lender's Alert - California Legislature Enacts Law Revising Foreclosure Process - click here.

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NOTICE OF SALE PURSUANT TO SECTION 2924.8 OF THE CIVIL CODE

Foreclosure process has begun on this property, which may affect your right to continue to live in this property. Twenty days or more after the date of this notice, this property may be sold at foreclosure. If you are renting this property, the new property owner may either give you a new lease or rental agreement or provide you with a 60-day eviction notice. However, other laws may prohibit an eviction in this circumstance or provide you with a longer notice before eviction. You may wish to contact a lawyer or your local legal aid or housing counseling agency to discuss any rights you may have.

出售公告 依据民法典第2924.8章

因本房产的赎进程序已经开始,这可能会影响您在此继续居住的权利。从本通知起的二十天后,本房产可能会被出售。如果你是租房户,新的房主可能给你新的出租协议,或通知您在60天内搬家。但有些法律可能禁止在此情况下的清房,或可为您提供更长的搬家期限。您可以与您的律师,您当地的法律援助或房屋咨询机构讨论您的有关权利。

매매 통고 민법 제 2924.8 항에 의거

이 건물에 대한 차압 절차가 시작되었으며, 그로 인해 귀하가 이 건물에서 계속해서 거주할 수 있는 권리에도 영향이 미칠 수 있습니다. 이 통고문의 날짜로부터 20일 혹은 그 후에, 이 건물은 차압 매매될 수 있습니다. 만약 귀하가 이 건물을 임차하고 있다면, 새로운 건물 소유주는 귀하와 새임대차 계약을 하거나 또는 60일 이내 퇴거하라는 통고를 할 수 있습니다. 그러나, 다른 법률들은 이런 상황에서의 퇴거를 금지하거나 또는 귀하에게 퇴거하기 전까지 연장된 기간의 통고를 하도록 할 수도 있습니다. 귀하의 권리에 대한 상담을 하기 위해 귀하는 변호사 또는 귀하가 있는 지역의 법률 구호 기관 혹은 주택 상담 기관에 연락할 수도 있습니다.

ANUNCIO DE VENTA SEGÚN LA SECCIÓN 2924.8 DEL CÓDIGO CIVIL

El proceso de ejecución de hipoteca ha comenzado en esta propiedad, lo que puede afectar su derecho de vivir en esta propiedad. La propiedad puede ser vendida en ejecución de hipoteca veinte días o más después de la fecha de este aviso. Si usted está rentando esta propiedad, el nuevo dueño de la propiedad puede darle a usted un nuevo contrato de arrendamiento o alquiler o darle un aviso de desalojo de 60-días. Sin embargo, otras leyes tal vez puedan prohibir un desalojo en esta circunstancia o proveerle a usted un aviso de desalojo de más tiempo para que desaloje la propiedad. Tal vez usted desee comunicarse con un abogado o su ayuda legal de la localidad o agencia de consejería de vivienda para hablar de cualquier derecho que usted tal vez tenga.

PAUNAWA SA PAGBENTA BATAY SA SEKSYON 2924.8 NG NILAGDAANG SIBIL

Ang proseso ng pagreremata ay nagsimula na sa pag-aaring ito, na kung saan ay maaaring makaapekto sa inyong karapatan na tuluyang manirahan sa pag-aaring nabanggit. Dalawampung araw o higit pa matapos ang petsang naisagawa ang paunawang ito, ang nasabing pag-aari ay maaari nang ibenta batay sa pagremata. Kung kayo ay nangungupahan sa pag-aaring ito, ang bagong may-ari ay maaaring magbigay ng bagong kasunduan sa paghiram o pagbenta o bigyan kayo ng kasulatan na paunawa na makalipat sa loob ng 60 na araw. Gayunpaman, maaaring ipagbawal ng ibang batas ang pagpapaalis sa pagkakataong ito o maaaring bigyan kayo ng mas mahabang panahon bago ang pagpapaalis. Minumungkahi kayong makipagbigay alam sa inyong abogado o lokal na katulong pang-legal o ahensiya ng payong pabahay upang pag-usapan ang alinmang karapatan na kayo ay mayroon.

THÔNG BÁO BÁN THEO ĐIỀU 2924.8 BỘ LUẬT DÂN SỬ

Việc bắt đầu tịch thu tài sản này có thể ảnh hưởng đến quyền tiếp tục sinh sống của bạn tại đây. Bắt đầu từ hai mươi ngày trở đi sau thông báo, tài sản này có thể bị tịch thu để trả nợ. Nếu bạn đang mướn nhà tại đây, chủ tài sản mới sẽ gửi cho bạn cam kết mới về việc thuê hoặc mướn hoặc có thể sẽ gửi cho bạn thông báo rời khỏi nhà trong vòng 60 ngày. Tuy nhiên,một số luật khác có thể không cho phép việc yêu cầu rời khỏi nhà trong trường hợp này mà gửi cho bạn thông báo sớm hơn trước khi yêu cầu bạn rời đi. Bạn nên liên hệ với luật sư hoặc tổ chức giúp đỡ luật địa phương hoặc cơ sở tư vấn nhà để tham khảo những quyền bạn có.